

Session I: Improving usefulness of fund objectives and policy

One of the areas of concern identified by the asset management market study was the usefulness of fund objectives for investors. The market study found that it is difficult for investors:

- to know what to expect from a fund before they invest in it
- to assess whether or not a fund they have invested in is performing against relevant objectives

This working group has been set up to develop, discuss, and, where possible, gain agreement on how to improve the usefulness of fund objectives for investors and how to make funds more comparable on the basis of their stated objectives and investment policies (OIP). The four sessions will cover:

- How to improve the clarity and usefulness of fund OIP
- How to make fund OIP easier to compare
- How to make fund OIP more measurable
- The most effective ways to implement any proposals

The focus of the working group is not on whether fund managers adequately comply with existing rules. We want to focus discussion on how managers can communicate with investors on the fund's OIP in more engaging and meaningful ways and what 'better communication' looks like.

This paper sets out the issues we want to raise in the first session of the working group and some initial thoughts on the questions for discussion.

In the first session we want to consider how fund managers can better articulate and explain the fund's OIP, including improving clarity about what the fund is trying to achieve and how it will achieve this.

Topics for discussion

1. What are fund objectives and investment policies for?

Background

Clearly articulated fund OIP tell investors what a fund aims to do and how the manager will try to achieve that. This should help investors understand whether a fund is right for them.

Regulation requires that a fund's OIP should be disclosed in certain mandatory disclosures (see accompanying regulatory background). While there are some elements of content that are required, the requirements are quite high-level and there is significant flexibility for managers in how they describe the OIP.

Managers also disclose information about funds in fund factsheets, although this is not a regulatory requirement. Many products have a great deal of information about them contained within disclosure documents and marketing materials, but it can be difficult to see all the relevant information in one place, sometimes there are differences between how information is communicated in different materials, and in some cases an investor may need to infer how a fund is run from other information such as information about the largest holdings or a commentary on the fund's performance.

Questions

- How can fund OIP help interested investors understand what a fund is actually doing?
- How do managers determine what information about the fund they put in the OIP? How far are fund OIP drafted with existing generic fund categories in mind, rather than to explain what the manager will be doing?
- How can investors more easily access important details (e.g. about ethical investment constraints) in a single place?

2. How can fund investment objectives and policies be made clearer?

Background

Fund OIP are often described in technical language, using jargon or terms which may not be easily interpreted by investors. There is potentially an opportunity for managers to explain the fund's OIP in simpler terms and to minimise the use of jargon. Some investors may understand individual terms, but may not be able to make sense of how the information should be read together, in particular where an index or benchmark is used.

Funds typically have a generic financial objective, which is either capital growth or income. While this may provide some information, it may not be particularly useful for investors. For example for the vast majority of funds, the objective of capital growth (as opposed to simply capital preservation) is the rationale for investing in the first place. This therefore provides little differentiation between funds.

In the last few years outcome-focused investment products, i.e. products that are intended to meet a specific investment objective, have become more popular. These products can express objectives in a way that relates more clearly to the outcome the manager hopes to achieve.

Usually information provided about the fund's investment policy is simply a breakdown of asset classes the fund may invest in. This is often followed by a statement that the manager may deviate from the stated mandate but with little detail on what might cause that shift. Managers may want a broad mandate but in many cases this broad mandate does not appear to reflect how the fund is run. The OIP needs to balance communicating the range of possible investments against a description of how the manager will use that mandate.

Most managers provide very little detail about the fund's investment strategy, i.e. the approach taken to deliver the fund's objectives. Managers may take a 'value investing' approach, a 'growth approach' or a 'constrained approach', etc. Investment strategies can vary significantly for funds with similar financial objectives and invested in the same asset class and can be an important distinguishing factor for some investors. It may also be important to understand the investment strategy to be able to evaluate the manager.

Questions

- How far do financial objectives distinguish between products? Is there any aspect of these that could be more useful to investors?
- Are there any lessons to be learnt from how outcome-focussed products describe their objectives that can be applied more generally?
- How can managers balance providing more clarity on the fund's investment policy with retaining flexibility?
- Should information about the investment strategy be a more prominent element of the OIP?

3. What are the barriers to writing clearer fund objectives?

Background

Some fund managers have told us that the advice they receive from external legal counsel prevents them from being more creative and makes minimising legal risk their main focus when drafting the disclosure documents. However, we have not seen specific examples of where disclosure documents have been materially altered as a result of legal advice. We have also heard that firms sometimes prefer to use a single version of the OIP, which is initially drafted for the prospectus, and then inserted into other materials as appropriate.

Feedback to the FCA's Smarter Communication initiative was that because there are detailed rules which prescribe the content of the UCITS KIID, firms feel they have limited latitude to make the content more effective or engaging. Firms also feel they need to be cautious in the development of marketing material to run alongside the KIID, on the basis that there is a regulatory requirement that other marketing material should not diminish the significance of the KIID.

The KIID rules prescribe what must be disclosed under certain headings, but provide for the fact that other information may be necessary, for example to adequately describe the OIP. The KIID regulation specifically envisages that the KIID OIP will contain more information than the prospectus description of the OIP. This requirement not to diminish the significance of the KIID does not appear to limit the ability of firms to provide clear and helpful information either in the KIID itself or in other marketing material.

Managers may believe that the fund's OIP is too complicated to be explained in a simpler non-technical format or doing so would omit important information. In this instance, it may be important for the manager to give a clear explanation in the OIP of the target market for the product.

Questions

- How far do regulatory minimum requirements set what is included in OIPs?
- How far do the OIP disclosed in the prospectus limit clearer disclosure?
- Are there examples where the OIP have been materially amended because of legal advice? Are there particular legal firms (or opinions) which exercise influence in this area?
- Are there other technical or legal barriers to establishing clearer OIP?