

# **Asset Management Market Study remedies and changes to the handbook – Feedback and final rules to CP17/18**

**Policy Statement**

PS18/8

April 2018

## This relates to

Consultation Paper 17/18 which is available on our website at: [www.fca.org.uk/publications/consultation/cp17-18.pdf](http://www.fca.org.uk/publications/consultation/cp17-18.pdf)

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# 1 Overview

## Introduction

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- 1.1** In our Final Report to the Asset Management Market Study (AMMS)<sup>1</sup>, and the preceding Interim Report, we set out evidence of weak price competition in a number of areas of the asset management industry. This matters to millions of investors. We estimate that over three quarters of the UK population are exposed to the asset management sector either directly, or via their pensions. Given the number of people impacted and that even small differences in charges can have a significant impact on people's savings over time, there is a significant amount of potential harm to be addressed.
- 1.2** The policies (remedies) in this Policy Statement (PS) are an important part of a wider package to improve competition in this industry for consumers. This PS follows Consultation Paper (CP) 17/18 and sets out final rules and guidance. In CP17/18 we consulted on changes to our rules and guidance for Authorised Fund Managers (AFMs), including changes to their governance arrangements that focused on the duties they have as the agents of the investors in their funds. This PS also feeds back on a related proposal about how our changes work with the Senior Managers and Certification Regime (SM&CR) discussed in CP17/18, but formally consulted on in CP17/25.

## Who this affects

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- 1.3** The new policy contained within this PS applies to UK AFMs in respect of their management of authorised funds (that is, authorised open-ended collective investment schemes).
- 1.4** This paper will be of interest to other firms in the investment management industry, such as entities acting as delegated portfolio managers, the depositaries of authorised funds and financial advisers. It will interest industry representative bodies.
- 1.5** The paper will be of interest to insurers running unit-linked and with-profits funds, as well as to UK-listed investment trusts, in respect of our commentary on the potential for the extension of the AMMS remedies covered in this PS to those sectors.

## Is this of interest to consumers?

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- 1.6** Investors in funds run by UK AFMs will be interested in this paper. This includes retail investors, professional investors, advisers and their representatives.

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<sup>1</sup> <https://www.fca.org.uk/publications/market-studies/asset-management-market-study>

## Context

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- 1.7** We have identified several drivers of weak competition in a number of areas of the asset management sector. Some investors are not well placed to find better value for themselves, and can be relatively insensitive to the price of asset management services. Such investors struggle to protect their own interests and through this to drive competitive pressure on asset managers to deliver good products and services at competitive prices. To help mitigate this, in CP17/18 we consulted on governance remedies focussed on AFMs as agents of their underlying investors. The proposed changes strengthened the duty on AFMs to act in the best interests of investors.
- 1.8** We consulted on rules requiring AFMs to pay any profits they may earn when dealing as principal in the units of a dual-priced fund without putting their own capital at risk (so-called 'risk-free box profits') back into the fund. We also consulted on changes to our non-Handbook Guidance FG14/4, to make it easier for AFMs to move investors from more expensive share classes to cheaper but otherwise identical classes.
- 1.9** The remedies set out in this PS are part of an overall package.<sup>2</sup> We are also publishing a CP with proposals to improve clarity over what a fund is offering (what it aims to do, how it intends to do it, and how performance is shown) as we believe that a lack of clarity is another reason for weak competition. The proposals aim to help those investors, and their advisers, who are able to make use of better information to choose the right funds. This incorporates the work of our fund objectives working group. The group included a wide range of stakeholders including asset management firms and investor groups. We are grateful for the time and expert input of this group.
- 1.10** Taken together, our remedies seek to address both demand and supply side problems in the asset management market which, if addressed, should lead to greater competition and innovation in this market in the interests of the consumers it serves.
- 1.11** The AMMS also highlighted the importance of clear disclosure of what asset management services cost through the presentation of a 'single charge'. The recast Markets in Financial Instruments Directive (MiFID II) and the Packaged Retail and Insurance based Investment Products Regulation (PRIIPs) have recently introduced greater disclosure of all costs and charges, including transaction costs. Consumers should now see the full costs and charges, expressed as a single fee, for most transactions in investment products, and on an ongoing basis. This is a significant step forward, but how the new information is presented will be important if it is to help consumers make more informed choices. To better understand this we conducted behavioural testing. We have published the results of the testing alongside this PS in an Occasional Paper.<sup>3</sup> The findings are consistent with a significant body of previous work. Firms should consider the results when thinking about how their disclosures are working.
- 1.12** In response to other concerns highlighted by the AMMS, we are supporting an independent Institutional Disclosure Working Group (IDWG). The group is seeking to agree a disclosure framework to support consistent disclosure of costs and charges to institutional investors.

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<sup>2</sup> See Appendix 3 (graphic of remedies)

<sup>3</sup> [www.fca.org.uk/publication/occasional-papers/occasional-paper-32.pdf](http://www.fca.org.uk/publication/occasional-papers/occasional-paper-32.pdf)

- 1.13** We have also referred the investment consultancy market to the Competition and Markets Authority for a market investigation.<sup>4</sup> That investigation is now under way.

## Summary of feedback and our response

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### Our governance proposals (Chapter 2)

#### *Strengthening the duty of AFMs to act in the best interest of their investors – our Value for Money proposal*

- 1.14** There is an existing duty on AFMs to act in the best interests of fund investors.<sup>5</sup> In our view, as part of fulfilling this duty, AFMs should assess and justify to their fund investors the charges taken from the funds they manage in the context of the overall service and value provided. We believe this is important as AFMs are the agents of the investors in their funds; they are not just product providers. In CP17/18 we called this a consideration of 'value for money' (VfM). We have found that AFMs generally do not consider robustly whether they are delivering VfM, despite their existing obligations.
- 1.15** For many retail and institutional investors, making informed investment decisions can be hard. To protect those investors that are not well placed to find better value themselves, we consulted on proposals to strengthen and clarify AFMs' duty to act in the best interests of fund investors. Specifically, we said that they must assess the VfM of each fund against a non-exhaustive list of prescribed elements, conclude that each fund offers good VfM or take corrective action if it does not, and explain the assessment annually in a report made available to the public.
- 1.16** On balance, stakeholders supported what we were trying to achieve with our proposals, agreeing that value is at the heart of the asset management proposition. However, many stakeholders expressed concerns with our drafting. A key concern was that our draft rules appeared unduly focused on assessing charges from the starting point of AFMs' costs, rather than the overall value an individual fund provides. Other stakeholders wanted us to be clearer on what we meant by 'value for money' in this specific context. Most stakeholders wanted us to extend the proposed implementation period for these rules, given other pressures on the sector in the short term.
- 1.17** We have considered the feedback carefully and still believe that the core of our policy is correct – that agents should be accountable to their underlying beneficiaries on how they deliver value. We accept that our draft rules could be seen as too focused on AFMs' costs rather than the full value proposition of funds, which was not our intention. We have redrafted our final rules to clarify that fund charges should be assessed in the context of the overall value delivered, rather than using the term 'value for money'. We have also decided to extend the implementation period for this requirement from 12 to 18 months.

#### *Independent Directors*

- 1.18** AFM boards must balance the interests of their fund investors and shareholders. The market study suggests that this balance is not always being struck appropriately,

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<sup>4</sup> <https://www.fca.org.uk/publications/market-studies/asset-management-market-study-final-decision-mir>

<sup>5</sup> See COLL 6.6A.2R and COBS 2.1.4R.

and we believe this is in part due to the fact that AFM boards are generally staffed exclusively by executives of the firm. To rebalance this and to help make sure that the best interests of investors are subject to greater scrutiny and challenge, we proposed rules requiring AFMs to appoint independent directors to their board. We proposed that AFMs appoint a minimum of two independent directors and for them to comprise at least 25% of the total board membership.

- 1.19** The overall response to our proposal was supportive. However, there were concerns about the costs for AFMs with smaller businesses, and whether these costs could create disproportionate barriers to entry for start-ups. We received responses asking us to introduce a threshold below which an AFM would not be required to have independent directors. Most stakeholders wanted us to extend the proposed implementation period for this requirement, given other pressures on the sector in the short term.
- 1.20** We think that the introduction of independent members to AFM boards will lead to better outcomes for investors, so we have made final rules introducing this requirement as consulted on. We think the benefits of independent scrutiny should be enjoyed by all investors, irrespective of the size of the business of the AFM running the fund they have invested in, and irrespective of how long the AFM has been operating.
- 1.21** We recognise that the requirement introduces costs, but believe that overall these are proportionate to the benefits we expect independent directors will bring to the running of funds. We believe that these costs are justified even in the early years of start-up AFMs, as the challenge independent directors bring is particularly important in a firm's formative years when its strategy and culture are set. As set out in CP17/18, we believe that all investors should benefit from the introduction of independent directors. However, we have extended the implementation period for this requirement from 12 to 18 months.

### **SM&CR**

- 1.22** In CP17/18, we stated that we would consult on a new specific Prescribed Responsibility (PR) for AFMs, as part of the extension of the SM&CR to almost all financial services firms. This PR would make clear that a Senior Manager, usually the chair of the board of an AFM, must take reasonable steps to ensure that the firm complies with its obligation to carry out the assessment of value, the duty to recruit independent directors, and the duty to act in the best interests of fund investors. We consulted on the detail of this specific PR for AFMs in CP17/25.
- 1.23** In CP17/18, we noted that there are benefits to appointing either an executive or independent member of the board to the position of chair and consulted on rules that would allow an AFM board to make this decision itself.
- 1.24** The vast majority of respondents agreed with our proposals. A small minority did not think that we should bring in a specific PR for AFMs, and others focussed on the independence of the chair, suggesting that chairs of AFM boards should be independent.
- 1.25** After considering the feedback, we have decided to introduce the PR for AFMs as part of the extension of the SM&CR. We also continue to believe that AFMs should decide for themselves whether to appoint an independent director as chair or not. We intend to publish the rest of our final rules for the extension of the SM&CR later this year.

**Share classes (Chapter 3)**

- 1.26** In CP17/18 we consulted on changes to our guidance to make it easier for fund investors to be moved (converted) to cheaper but otherwise identical classes of the same fund. The main change was to remove the need for an AFM to get consent from each investor before converting them.<sup>6</sup>
- 1.27** All respondents supported our aim of making it easier to move investors to cheaper classes. There was a lot of support for removing the need for an AFM to get individual consent from every investor before conversion. However, a significant number of respondents said that the open-ended notification requirements we consulted on were still too onerous and therefore likely to continue to prevent AFMs carrying out class conversions in practice.
- 1.28** We have published final recast guidance which removes the need for the AFM to get individual consent from each investor before converting them. The recast guidance now recommends AFMs make a simple, one-off notification to investors, which does not require a response, a minimum of 60 days before a mandatory conversion.

**Trail commission**

- 1.29** CP17/18 asked questions for discussion about whether we should continue to allow the payment of trail commission. We received a range of feedback on both sides of the debate. We are grateful to respondents for sending us their views, which will inform our wider consideration of trail commission. We are still considering the issue and have no immediate plans to bring forward proposals for policy change at this point.

**Box profits (Chapter 4)**

- 1.30** We found that the managers of some dual-priced authorised funds were making a risk-free profit when dealing as principal in the units of their funds. In CP17/18 we proposed that these profits should be repaid to the fund, for the benefit of investors. Most respondents agreed with this. However, some, especially those directly involved in managing and administering authorised funds, were concerned about the practicalities of implementing our proposal as drafted and its possible unintended consequences.
- 1.31** We welcome the broad support for our proposal and have proceeded with it while making some adjustments to correct technical shortcomings in the draft rules and guidance. We are also allowing some flexibility in how risk-free profits should be allocated fairly and in the interests of investors. We are grateful to stakeholders for their technical input to the drafting.

**Extending the scope of our governance proposals to other investment products - discussion (Chapter 5)**

- 1.32** In CP17/18 we asked for views on extending our governance proposals for the authorised funds market to other investment products, specifically to unit-linked and with-profits insurance products and investment trusts (also referred to as investment companies). We said that we did not plan to extend the governance proposals to pensions, as we would instead consider this as part of our work on non-workplace pensions.<sup>7</sup> The feedback we received was mixed.

<sup>6</sup> We proposed to retain within the guidance a recommendation that AFMs should check that any mandatory conversion will be consistent with investors' best interests.

<sup>7</sup> We have published a Discussion Paper on this topic:  
<https://www.fca.org.uk/publications/discussion-papers/effective-competition-non-workplace-pensions-dp18-1>

- 1.33** We have planned diagnostic work into with-profits and unit-linked products that will improve our view of any harm that exists in these markets. We expect to reach a view on whether further intervention is required in the first half of 2019. We are keeping the possibility of further changes to investment trust governance arrangements under review, but we do not plan any immediate action on this.<sup>8</sup> Consistent with CP17/18, we are not bringing forward proposals on extending the governance proposals to pensions at this time.

**Summary of final decisions on the CP17/18 remedies – table**

CP17/18 consultation points	Decision
Value for Money assessments and reporting	Remedy introduced as final rules and guidance, with some changes including change of implementation date
Independent Directors – 25% and a minimum of two	Remedy introduced as final rules and guidance, with some minor changes including change of implementation date
SM&CR PR for AFMs (as consulted on in CP 17/25)	To be implemented as per consultation, as part of the wider extension of the SM&CR
Box Profits	Remedy introduced as final rules and guidance, with some technical changes and change of implementation date
Share Classes	Change introduced as final guidance, with some minor drafting changes
CP17/18 consultation points	Direction of travel
Adjacent markets	Diagnostic work into with-profits and unit-linked products planned. No immediate action planned on changes to investment trust governance arrangements.
Trail Commission	No immediate plans to bring forward policy change on this.

## Equality and diversity considerations

- 1.34** We have considered the equality and diversity issues that may arise from our proposals. Overall, we do not consider that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. We did not receive any feedback contradicting this conclusion.

<sup>8</sup> Investment trusts are corporations. Directors have responsibilities to their corporation's shareholders under company law. In addition, investment trusts are subject to Chapter 15 of our Listing Rules. One of the requirements under these rules is a requirement for investment trust boards to have a majority of independent directors.



## Next steps

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**1.35** AFMs should take note of the implementation dates of our final policies:

- final rules for our governance remedies – requiring AFMs to assess whether their offering is in line with their need to act in best interest of investors, and the independent directors requirements – will come into effect on 30 September 2019
- our final rules for the SM&CR PR for AFMs will come into effect at the same time as the rules for the extension of the SM&CR in general, which is expected to be in mid to late 2019
- our rules on box profits will come into effect on 1 April 2019
- our recast of Final Guidance 14/4, now known as Final Guidance 18/3, will be effective from the date of this publication

## 2 Measures to improve fund governance

**2.1** In this chapter we summarise the feedback received and provide our response on our CP17/18 proposals to:

- strengthen and clarify the duty of AFMs to act in the best interests of their investors and to provide for greater scrutiny of how AFMs are fulfilling this requirement through an annual report
- increase the level of scrutiny at AFM board level<sup>9</sup> by mandating a minimum number of independent directors
- clarify the accountability of the chairs of AFM boards in relation to these proposals

**2.2** These remedies focus on AFMs' duties as the agents of the investors in their funds, and are intended to better protect investors who are less able to exert demand side pressure and find value themselves. As set out in CP17/18 we found, as part of the market study, that retail investors do not usually negotiate with asset managers and that fund governance bodies acting on their behalf do not typically focus on value for money. We received 106 responses from a range of stakeholders, including large and small asset managers, consumer groups, individuals and other financial market participants.

### Strengthening our rules for AFMs to act in the best interest of their investors

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**2.3** There is an existing duty on AFMs to act in the best interests of fund investors. This derives in part from requirements of the Undertakings for Collective Investment in Transferable Securities (UCITS) and the Alternative Investment Fund Managers (AIFM) Directives. In our view, as part of fulfilling this duty, AFMs should consider whether the charges taken from a fund are justified in the context of the overall service and value they provide through that fund. This includes both charges that are usually paid directly to third parties<sup>10</sup> and the management fees that AFMs set for themselves. We believe this is particularly important as AFMs are the agents of their investors – they act on their behalf and owe them duties – they are not solely product providers. In CP17/18 we called this a consideration of 'value for money' (VfM).

**2.4** We have found that AFM boards generally do not consider robustly whether they are delivering VfM to their investors. In response to this we consulted on proposals to strengthen and clarify AFMs' duty to act in the best interests of their investors. Specifically, that as part of this duty they would be required to:

- assess the VfM of each fund against a non-exhaustive list of prescribed elements, including whether charges are reasonable in relation to the costs incurred in delivering the service, and the quality of the service provided

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<sup>9</sup> As explained below, our rules use the broader term 'governing body of an AFM'. Our use of the term 'board' in this PS should be read as referring to the governing body of an AFM.

<sup>10</sup> E.g. depositary fees, audit fees.

- conclude that each fund offers good VfM or take corrective action if it does not
- explain the assessment annually in a report made available to the public.

**2.5** Our proposal would require AFMs, as agents, to be more transparent in the decisions they are taking while managing other people's money. As set out in paragraph 3.31 of CP17/18, the intention was to encourage AFMs to offer better VfM as a result of the VfM assessments they carry out, or the consumer pressure from market commentary on their published reports - e.g. from the press and platforms - or both.

**2.6** In CP17/18, we asked:

- Q1:** *Do you agree that we should introduce a specific rule requiring AFM boards to assess value for money?*
- Q2:** *Do you agree with the specific requirements of the assessment? If not, what additional or alternative elements should be included?*
- Q3:** *Do you agree with the planned implementation period of 12 months? If not, what alternative timeframe would you suggest?*
- Q4:** *Do you agree with the proposed requirement for the AFM to publish a report on the findings of the assessment and the steps taken?*

## Feedback received

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**2.7** Most respondents supported our intention. There was broad support for our view that value is at the heart of the asset management proposition and that, as agents, fund managers owe duties to their underlying beneficiaries, the investors in the fund. Only a minority of respondents felt we should not introduce an obligatory assessment of value at all. A few argued that it was already inherent in the need to act in the best interests of fund investors so was unnecessary, or should be expressed as guidance. One respondent said we should not impose a value assessment duty on AFMs without having first considered the whole value chain including intermediation.

**2.8** However, many stakeholders expressed concerns about the drafting of the proposed rule and asked us to clarify our expectations in practice. A key concern was that the draft rule appeared unduly focused on assessing fund charges from the starting point of AFMs' costs, rather than the overall value provided including quality of service, performance and the potential to deliver value in the future. Some respondents were concerned about the use of the term 'value for money' and specifying what they felt was a fundamentally subjective judgement in rules. Industry respondents were concerned that the drafting could give investors the impression that the lowest charges always provide the best value and that "cheapest was always best".

**2.9** Many respondents made suggestions for changing the assessment criteria, in emphasis and detail. A few suggested adopting an approach based on the United

States model, including the Gartenberg principles<sup>11</sup>, instead. They said this model put a consideration of fund charges in the context of the overall fund management service provided. Several respondents thought that the assessment (and the reporting rules), should take into account each fund's objectives and the fact that most funds are medium to long-term investments. Many said that the performance of a fund should be an assessment criterion. A few respondents incorrectly thought that our draft rules meant the assessment should be solely based on past performance, something they said they did not support. Several mentioned the incoming product governance rules under MiFID II, and suggested incorporating those into the assessment. One respondent said that for ethical funds the assessment should include provisions on the trade-off between ethical policy and investment performance.

**2.10** Several respondents asked for clarification on whether identified savings achieved through economies of scale should be passed on to investors.

**2.11** Several respondents commented on how breakpoints were referenced in the draft rule. They acknowledged that breakpoints could be helpful, but argued that these should not be the only fees mechanism that could be considered. Other respondents felt we had underestimated the differences in the cost bases for running retail funds compared to institutional ones and should not assume the savings would be the same as funds grew.

#### ***Feedback on annual reporting about assessments***

**2.12** Several respondents argued that an annual report of the value for money assessment was misguided, as funds were usually medium to long term investments, and investment strategies with a long term view might underperform in the short term. Several respondents said that reporting should be based on the holding period of a fund, rather than annually.

**2.13** A few respondents were concerned that public reporting on the value for money assessment will force them to disclose commercially sensitive information and might be anticompetitive.

**2.14** Two respondents suggested that the annual report could be based on the format of an Independent Governance Committee's (IGC's) reporting on value for money.

#### ***Feedback on the implementation period***

**2.15** A few respondents stated that they had no objections to the proposed implementation period of 12 months, and one respondent suggested we should shorten it to 3 months. However, the vast majority of industry respondents asked for more time, because of the need to prepare their businesses for other incoming political and regulatory changes, with most requests for an extended period ranging from 18 to 36 months. Some respondents asked for the implementation period to be aligned with that of the SM&CR.

11 The widely accepted Gartenberg principles derive from United States case law. They relate to what points the board of an US mutual fund should have regard to, when, as required by Section 15 of the 1940 Investment Company Act, it is assessing the fund management contract (which will of course include the fee). The points are as follows:

1. the nature, extent, and quality of the services to be provided by the fund manager;
2. the investment performance of the fund and the fund manager;
3. the costs of the services to be provided and profits to be realized by the fund manager and its affiliates;
4. the extent to which economies of scale would be realized as the fund grows; and
5. the extent to which fee levels reflect these economies of scale for the benefit of fund investors.

## Our response

### Overall

The AMMS and our supervisory work have shown that in general, AFMs have not considered robustly the value they offer to investors under our existing rules. We believe that this is leading to harm to investors through poor value products.

With these findings, and having taken account of the feedback, we consider that the core of our policy is correct – that agents should be accountable to their underlying clients on how they deliver value. We have decided to make final rules in COLL to confirm our expectation that part of acting in the best interests of investors involves AFMs assessing whether (and demonstrating that) value is being delivered for investors. We consider that rules rather than guidance will enforce a level playing-field, as all AFMs will have to carry out the assessment and publish an annual statement describing it, aiding comparison across the sector.

However, we have amended the final rules to take account of the feedback we received, as we set out below.

### Commentary on our amended final rules including the reporting requirement

We have considered the feedback on the term 'value for money', with the calls for us to clarify what we expect of AFMs. We have changed the final rules to clarify the detail of the assessment we require AFMs to carry out, and the judgements we expect them to make.

We accept that our draft rules could be seen to be too focused on AFMs' costs rather than the full value proposition of funds, which was not our intention. We have redrafted COLL 6.6.20R to clarify that fund charges should be assessed in the context of the overall service delivered. The final rule is closer to the 'Gartenberg principles' in the U.S. (see footnote 11 above for more detail about them). We have refined the non-exhaustive list of elements prescribed for the assessment in the table in COLL 6.6.21R. This table retains the quality of services provided and we have added guidance that this could include, for example, the quality of the AFM's internal investment process.

The table also now explicitly includes fund performance. Our redrafting clarifies that AFMs can assess performance over a time period appropriate to the fund's investment objective, policy and strategy. We confirm that the assessment can assess past and reasonably expected future performance and should not be solely based on actual past performance, short term or otherwise.

A consideration of AFMs' costs, and of economies of scale, remains part of the assessment. We clarify that a comparison of fund charges with charges levied on similar strategies delivered by the AFM through other services, including segregated mandates, is also a prescribed element within the assessment, if applicable. The AFM must also consider market rates for comparable services, whether the AFM provides the service itself or receives it from another supplier.



We accept feedback that our draft rules' focus on breakpoints was too detailed and prescriptive, as there are many ways AFMs could choose to offer more value to fund investors. We have removed the direct reference to breakpoints from the final rules. AFMs remain able to consider additional elements as part of their assessment, and report on these, but we have clarified that where they do this, they must set out the basis on which these additional elements have been considered. The list of elements sets a minimum basis for the assessment, but it does not constrain the exercise of judgement by AFMs on other elements of their service that are relevant, or inhibit innovation in their offering to investors.

The provision to consider economies of scale does not prevent AFMs from, for example, reinvesting savings achieved through economies of scale into the business, subsidising other parts of the business or covering development costs. However, firms will have to explain these decisions in the annual report and show how these decisions, along with others flowing from the assessment, are in the best interest of the investors.

An annual, public statement describing the assessment conducted by the AFM is an important part of our package and helps with transparency and scrutiny of these assessments across the industry. As set out above, we are providing for a consideration of performance that reflects the timescale over which a fund will try to achieve its objectives. AFMs can reflect this in their annual statements. AFMs can explain why their fund is currently underperforming if they think it will help investors to understand their strategy. It would not make sense to require statements to be published in line with the recommended holding period of a fund – which could be years – as people invest in funds on a rolling basis, and often for shorter periods than the recommended holding period. Reporting so infrequently would significantly reduce the impact of this policy.

AFMs can explain in their annual statement why retail funds and institutional mandates are not comparable, if the AFM believes this to be the case. We do not expect firms to disclose information which is commercially sensitive or anticompetitive. Our proposals do not affect existing competition law, which continues to apply.

For a fund set up as an umbrella, the value assessment will take place on a sub-fund-by-sub-fund basis. The statement setting out a description of the assessment of value will need to describe each sub-fund individually.

AFMs can choose the way they communicate quantitative and qualitative information, but they must comply with our rules for communications to be fair, clear and not misleading.

### Implementation period

Considering the weight of the feedback in the context of other pressures on the sector, we have extended the implementation period for this requirement. Instead of coming into effect 12 months from the date of publication of this Policy Statement, these rules will now come into effect approximately 18 months from that date on 30 September 2019.

AFMs must publish a statement setting out a description of the assessment of value, either in the fund's annual report or in a separate composite report. In either case, the statement must be published within 4 months of the end of the relevant annual accounting period. We have added a transitional rule so that a statement setting out a description of the assessment of value is not required for an annual accounting period that ends before 30 September 2019.

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## Independent directors on AFM boards

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- 2.16** AFM boards must balance the interests of their investors and shareholders. The market study suggests that this balance is not always being struck appropriately, and we believe this is in part due to the fact that AFM boards are generally staffed exclusively by executives of the firm. To rebalance this and help to make sure that what is in the best interests of investors is subject to greater scrutiny and challenge, we proposed that AFMs appoint a minimum of two independent directors and for them to comprise at least 25% of the total board membership.
- 2.17** We proposed that independent directors can serve for no more than ten years at once, and that directors may not be eligible for reappointment to the same AFM until five years from the end of their last term. We did not consider it necessary to propose a limit on the number of AFM boards an independent director can serve on. They would need to have enough experience and expertise to fulfil their role, but financial services expertise is not compulsory.
- 2.18** To qualify to serve as an independent director, people can't have been paid by the AFM group for five years before their appointment, or had a material business relationship with it for the last three years.
- 2.19** In CP17/18, we proposed not to introduce a minimum threshold for smaller firms to comply with the requirements to appoint independent directors. We considered that all investors should benefit, regardless of the size of the fund or the AFM running it. Finally, we proposed an implementation period of 12 months following the finalisation of these rules.
- 2.20** In CP17/18, we asked:

**Q5:** *Do you agree with our proposal to require AFMs to appoint independent directors to the board? If not, what alternative(s) would you propose?*

**Q6:** *Do you agree with the proposed proportion of independent directors (at least two and not less than 25% by number)?*

- Q7:** *Do you agree with our approach that independent directors may serve on more than one board, provided that they comply with existing rules? If not, do you think a ban on serving on more than one board is necessary?*
- Q8:** *Do you agree with the proposed requirements for being an independent director? If not, what alternatives do you propose?*
- Q9:** *Do you agree with an implementation period of 12 months? If not, how much time do you think AFMs will need to appoint suitable independent directors?*

## Feedback received

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- 2.21** The overall response to our proposal was supportive. However, there were concerns about the costs for AFMs with smaller businesses, and whether these could create disproportionate barriers to entry for start-ups. We received responses asking us to introduce a threshold below which an AFM would not need to have independent directors.
- 2.22** One respondent said that AFMs should only appoint independent directors where it would clearly enhance the effectiveness of the board and that a minimum number of independent directors should not be set by rules. Another respondent stated that they do not believe independent directors will bring any improvement in the value for money delivered to clients. They said that the industry should focus on a fee model that better aligns the interests of investors and clients.
- 2.23** The remaining feedback focussed on points of detail and requests for us to clarify how the rules will work in practice. Some respondents wanted to know how the requirement to appoint independent directors to AFMs would affect legal structures other than corporations. One respondent asked us to enhance the procedures and protections around how independent directors can have their employment terminated, to give them the confidence to provide challenge. They asked for independent directors to be protected under the Financial Conduct Authority (FCA) whistle-blowing provisions among other protections and were concerned that without these measures, "independent" directors might become more easily "captured" by the AFM.
- 2.24** Several respondents asked for further clarification on how the obligation to assess value delivered for fund investors sat with the general duties of directors, including their need to consider their shareholders. They also asked if, as suggested in draft COLL 6.6.26G (4) (guidance that relates to COLL 6.2.5R (6)), an AFM could be required to act "solely" in the interest of investors.
- 2.25** Two respondents stated that, while they agreed with the proposal for 25% of directors to be independent, they were against the requirement to appoint at least two. Two other respondents argued that boards should have majority independence, as this would be more effective and be consistent with IGCs and the corporate governance code, which states that at least 50% of directors should be independent (excluding the chair). One respondent suggested increasing the requirement from 25% to one third of the board.



- 2.26** Several respondents were concerned about our proposal to allow independent directors to serve on more than one board, because of concerns about professional secrecy and conflicts of interests. One respondent asked us to limit the number of AFM boards an individual can serve on at the same time, as they said 'full-time' independent directors might be less likely to "rock the boat". One respondent agreed that we should not impose a limit but asked us to keep this provision under periodic review. Two respondents asked if an independent director could serve on multiple AFM boards for the same asset management entity or group. Another respondent asked whether a consultant appointed on a third party contract for a limited amount of time within the five years could still be considered independent.
- 2.27** Many respondents were concerned about the limitations imposed by the independence requirements arguing that this would make it difficult to find suitable candidates. One said that restrictions on prior employees should be limited to those who worked on the relevant fund range.
- 2.28** A few respondents were concerned about the experience required for independent directors. One argued that independent directors should have financial services experience so they can provide sufficient input. Another suggested that expertise and experience in other areas of financial services was not always transferable to fund management.
- 2.29** One respondent asked us to also consider personal, family or business relationships with other directors, as this could compromise independence.
- 2.30** Another respondent said that independent directors should not be allowed to serve for longer than 3-6 years as this could compromise their independence. One respondent suggested that directors should be considered as potentially independent two years after previous dealings with the AFM, rather than the proposed five.
- 2.31** Many respondents were concerned about the proposed implementation period of 12 months, given the impact of other regulatory changes and the challenges of preparing for Brexit. Suggestions for an extension ranged from 18 to 36 months.

### Our response

Noting the broadly positive feedback, and because we consider that the introduction of independent members to AFM boards will benefit investors, we have made final rules introducing this requirement as consulted on, except for some minor adjustments.

We think all investors should benefit from independent scrutiny no matter how large the AFM is and how long it has been operating. We recognise that this will cost money, but believe that this is proportionate to the benefits we expect independent directors to bring. We believe that the cost is justified even in the early years of start-up AFMs, as independent directors' perspectives are particularly important in a firm's formative years during which, for example, its strategy and culture are set.

We have also considered whether there should be a minimum value of assets under management (AUM) before the requirement applies. There

are a number of practical challenges in applying that approach but more importantly, we believe it is important that all investors benefit from the improved challenge independent directors can bring and they are not put in the position of having to determine whether a particular AFM is subject to this rule. We have decided to apply the requirement for independent directors to all AFMs.

Because our rule refers to the 'governing body' of the AFM, it is suitable for any legal entity that can become an AFM, so all our requirements will apply equally to every AFM.

Specific whistleblowing provisions derived from European legislation, such as the UCITS Directive and MiFID II, will apply to many AFMs. The Public Interest Disclosure Act 1998 and its provisions apply to essentially all UK firms. The majority of provisions in SYSC 18 will not apply to AFMs, but it is for firms to consider the appropriate arrangements in light of their structure and business model. Firms may find it helpful to consider SYSC 18 when determining the measures appropriate to their circumstances.

In our SM&CR consultation paper (CP17/25) we consulted on the application of Senior Manager Conduct Rule 4 (SC4 – COCON 2.2.4R) to Non-Executive Directors (NEDs) even where they do not require FCA approval to carry out their roles (this category will include the independent directors considered in this chapter). These rules have not yet been finalised, but the application of SC4 to all NEDs would impose a requirement for NEDs to disclose any information to the FCA of which we could reasonably expect notice. This may include any relevant reports by whistle blowers. All Senior Manager Conduct Rules would apply to individuals approved for Senior Management Functions, such as the chair.

We don't think the need to act in the best interests of fund investors conflicts with directors' general duties. These duties are not limited to shareholders or financial success alone. Independent directors will bring an external perspective and support executive directors. We accept the concerns expressed regarding the word "solely" in COLL 6.6.26G (4) and have deleted it from the final guidance.

We have considered arguments for and against going further on board independence. We have concluded that the proposal we consulted on is the most proportionate approach. AFMs may choose to appoint additional directors if this is right for their business.

We will monitor the success of the proposal, and will consider introducing a higher threshold of independence, including a requirement to have a majority independent board, at a later stage if needed. We have considered respondents' concerns about independent directors attending multiple boards, across different commercial groups, and we recognise that legitimate concerns will exist about confidentiality and other conflicts of interest. These considerations may mean that it does not become common practice for independent directors to serve on the AFM boards of different groups. However, we consider that it should

be up to AFMs to decide if they accept independent directors who also serve on other boards. We will monitor this situation.

Independent directors can sit on more than one AFM within a group under our final rules. However, the time served will be calculated on a group basis. An independent director can serve a term of up to five years (renewed once to a maximum of ten years) within one group, starting from the time of the first appointment. We have also clarified in our final rules that a director, having already started to serve on the board of one AFM within a group, is not prevented from serving on another board within the same group, as long as the overall time limits are not breached.

Our final rules clarify that AFMs which already have independent directors, prior to the implementation date of these rules, can keep them on their boards as long as they meet the independence requirements set out in COLL 6.6.25 R<sup>12</sup>. Once the rules come into force, existing independent directors can serve for a maximum term of five years (renewed once to a maximum of ten years) – the clock starts on the date the rules come into effect.

The FCA will not play any part in the recruitment process, nor will we approve candidates.

We don't think that AFMs will struggle to find suitable independent directors. Feedback from the investment trust sector, which already requires a majority independent board, suggests that there is a pool of capable, financially literate candidates. We encourage AFMs to look outside the pool of usual candidates in their search for independent directors. Amongst others, we would point towards the Investment Association's recently launched five-year initiative to increase diversity in the boardroom. This calls for greater diversity across a range of dimensions: gender, ethnicity, socio-economic background, LGBTI+, age and disability.

A criterion of independence is that there should be no monetary link to the entire company, which would not be achieved by limiting these restrictions to former employees of the fund range only. We have not changed our approach on this.

We agree that a person with a close relative employed in a senior position in the AFM, or another firm in the same group, is unlikely to be considered independent under COLL 6.6.25R and we have amended our guidance accordingly.

We have noted the comments on reducing the required period before a director can be considered independent. However, to promote strong independent governance, we consider a minimum of five years is necessary.

It is up to AFMs to decide if there has been a 'material business interest' for the purposes of the independence rules. For example, AFMs need

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12 For these purposes any sort of remuneration is to be understood as any other remuneration apart from the fees they have received for their services as independent directors.

to decide when considering whether to appoint a former employee of a consultancy firm, where that employee had helped the consultancy deliver work for the AFM in the relevant period.

### Implementation period

Considering the weight of the feedback in the context of other pressures on the sector in the short term, we have extended the implementation period for this requirement from 12 to 18 months.

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## SM&CR Prescribed Responsibility and the appointment of an independent chair

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- 2.32** In CP17/18, we explained that we would consult on a new specific PR for AFMs, as part of the extension of the SM&CR. This PR would make clear that a Senior Manager, usually the chair of the board of an AFM, must take reasonable steps to ensure that the firm complies with its obligation to carry out the assessment of value, the requirement to recruit independent directors, and the requirement to act in the best interests of fund investors. The FCA has to approve the appointment of Senior Managers. We consulted on this PR in CP17/25.
- 2.33** In CP17/18, we noted the benefits of appointing either an executive or independent member of the board to the position of chair and consulted on rules that would allow an AFM board to make this decision itself. We asked:

**Q10:** *Do you agree that it should be up to AFMs to decide whether to appoint an independent director or an executive director as chair?*

## Feedback received

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### Prescribed Responsibility

- 2.34** We received several responses to our proposal to introduce a new PR for AFMs under the SM&CR. Most people agreed with our proposal, but a minority disagreed. Several respondents stated that the exact requirements were uncertain, that the value for money assessment was subjective, and that the person subject to the PR may be open to retrospective criticism.
- 2.35** Individual respondents raised a variety of different questions or suggestions in relation to the PR including that the PR should be split into two separate PRs, whether the PR should refer to managing conflicts of interests specifically, where certain responsibilities sat between the board and the chair, why this PR is the only sector specific one and whether more guidance on the PR could be provided.

### Chair of the board

- 2.36** We received several responses to our proposal to leave the decision on whether the chair should be independent up to AFMs. These responses were mixed, with different views on whether we should mandate an independent chair. Two respondents asked us to do this, given the importance of the position. One respondent suggested that the

perception of independence could be weakened if an independent director was not the chair. Another expressed a strong preference for an executive chair, as independent directors may not have sufficient knowledge of the business. Some respondents requested that we clarify an apparent inconsistency between CP17/25 and CP17/18 on the question of whether the PR would have to fall on an independent chair.

### Our response

After considering the feedback, we have decided to implement the Prescribed Responsibility for AFMs without further changes, as part of the extension of the SM&CR. We intend to publish the rest of our final rules for the extension of the SM&CR in summer 2018.

We have considered the arguments and concerns on independent chairs and think that AFMs should decide this themselves because there may be good reasons to choose either option.<sup>13</sup> However, we will monitor the situation carefully and propose rule amendments if necessary. We do not think that the substance of CP 17/25 (a SM&CR CP) contradicts CP17/18, although we accept that the language used may have been confusing.

We confirm that having an independent chair, or not, is the AFM's decision.

## Impact on the competitiveness of the UK - both governance proposals

- 2.37** Several commentators and respondents argued that the changes we are introducing on assessing the value delivered to investors and the appointment of independent directors will damage the UK's competitiveness, particularly after our exit from the European Union.
- 2.38** Some respondents were concerned about the potential for regulatory arbitrage if European Economic Area (EEA) non-UK AFMs use their passporting rights to manage UK funds, or to market EEA non-UK funds in the UK.

### Our response

We do not believe our proposals will damage the competitiveness of UK firms. We recognise that the proposed package of remedies will increase costs for some firms in the UK, but we expect that the benefits will outweigh any costs. We think it is vital to the competitiveness of the UK as a global centre for asset management that clients are confident that the UK fund industry offers good value. We also think our reforms will make the UK a more attractive place for investors and will make the UK asset management industry more competitive.

13 See paragraph 3.48 of CP17/18 for commentary on this.

## Cost benefit analysis - both governance proposals

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- 2.39** A small number of respondents raised individual issues or questions regarding our cost benefit analysis (CBA) including that we under-estimated how much it will cost to implement the new rules, for example with regard to the role of other personnel needed to assist the board to assess value. One respondent asked for clarification on the payment of directors. They interpreted the CBA as making the assumption that they would be 'paid from scheme property' and new payments out of scheme property would require a unitholder vote.

### Our response

Having considered the feedback, we believe that the conclusions of the CBA still stand. In particular we consider that the estimate that we set out in the CBA in CP17/18 for the cost of the time that support personnel will expend in assisting directors with the assessment of value remains valid. We would like to clarify what we believe is a misunderstanding on the part of one of the respondents. We assumed, for the purposes of the CBA, that the ongoing costs of the independent directors will be passed through to fund investors through higher charges. We did not, and do not, envisage that the costs would be paid directly from the fund to the independent directors. Rather, that the costs would flow through the AFM (i.e. that the AFM would charge the fund an additional amount to cover the payment by the AFM of the salaries and other costs associated with the independent directors). Whether the additional costs of independent directors should in fact be passed on to fund investors by the AFM charging the fund a higher management fee is of course a decision for AFMs.

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## 3 Moving fund investors to better value share classes

- 3.1** In this chapter, we summarise the feedback received and provide our response on our proposals to make it easier to move investors between share classes when this is in their interests.

### Our proposals

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- 3.2** In CP17/18 we consulted on changes to our 2014 non-Handbook guidance (FG14/4) to make it easier for fund investors to be moved to cheaper but otherwise identical classes of the same fund. We call this type of movement a 'conversion'. Our changes to FG14/4 covered AFMs with a direct legal relationship with the fund investor.<sup>14</sup> The key change was to remove the need for an AFM to get individual consent from each investor before converting them. This had previously been a barrier to the conversion of fund investors who did not respond to invitations from the AFM. We proposed to keep within the guidance a recommendation that AFMs check that mandatory conversions are in investors' best interests.
- 3.3** In CP17/18 we asked:

**Q11:** *Do you agree with the proposed modification of FG14/4?  
If not, what alternative(s) would you propose?*

### Feedback received

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- 3.4** All respondents supported our intent to make it easier to move investors to cheaper but otherwise identical classes. There was significant support for our main modification to FG14/4 - to remove the need for an AFM to get individual consent from every investor before conversion. However, one respondent said that this proposal interferes with a fund investor's rights and that it is a new departure.
- 3.5** Several respondents agreed that the guidance should continue to recommend that AFMs check that mandatory conversions are in investors' best interests. However, one respondent said that the need to record and demonstrate that a conversion was in the best interests of the investors is a significant burden on AFMs.
- 3.6** A significant number of respondents argued that the open-ended notification requirements we consulted on - for example for AFMs to make 'best efforts' and to consider general communications such as press adverts - were still too onerous and/or unclear and therefore likely to continue to prevent AFMs carrying out conversions.

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<sup>14</sup> i.e. that the relationship is not intermediated by a platform. FG14/4, includes a section of guidance on the situation in which a platform is involved. We did not consult on changes to this section, and did not receive any feedback on this section.



However, one respondent suggested that the FCA should require AFMs to use services to track unresponsive investors.

- 3.7** Two respondents suggested that a mandatory conversion should be cleared with the depositary in advance (instead of other actions such as informing the investors). Several respondents said that they didn't think the prospectus should have to allow for mandatory conversions, before such conversions are permitted. One respondent asked what AFMs should do when fund investors say that they do not want to be converted to cheaper but otherwise identical share classes. One respondent suggested AFMs simply reduce the management fees on the existing share classes.

### Our response

We have published final, recast non-Handbook guidance in which the need for the AFM to get individual consent from each investor before converting them is removed. We are keeping the recommendation that AFMs check mandatory conversions are consistent with investors' best interests beforehand. We think it is appropriate for AFMs to demonstrate that they have done this.

After consideration of the feedback, we have decided to amend the recast guidance so that it recommends AFMs make a simple one-off notification to investors, which does not require a response, a minimum of 60 days before a mandatory conversion. We think this will address concerns that the notification recommendations to AFMs that we consulted on remain too onerous and would in practice prevent conversions. The final guidance is in line with our requirements for AFMs making other changes of similar importance to authorised funds.<sup>15</sup>

We do not agree that AFMs should have to use tracing services as we think that this would be disproportionate. Fund investors cannot be made to respond to a notification and we don't think they should have to. We envisage this guidance being used primarily in situations where AFMs have already attempted to contact investors. In the final guidance we state that an AFM should not make other changes to investors' rights as part of a mandatory conversion to a cheaper but otherwise identical class.

We don't agree that removing the need for individual consent for a class conversion of the type we are considering here is a fundamental interference with fund investors' rights. Many other changes of similar or higher impact on fund investors can be taken by AFMs under our existing rules after a simple notification with no response required, or after a vote in a general meeting of fund investors (unitholders), in which only those investors who participate have a voice.

After consideration, we have discounted the idea of having depositaries check the merits of a proposed mandatory conversion. However, under existing rules, among other duties, depositaries must make sure that a proposed conversion meets the prospectus terms.

15 See COLL 4.3.



We disagree with respondents who said that mandatory conversions should be possible even if the prospectus does not allow them. We think it is an important investor protection for the AFM to formally set out, in a document that is widely available, the extent of its right to carry out such transactions without the fund investors' express consent.

As suggested by respondents, one option for an AFM to consider is simply to reduce the charges on expensive classes from before the retail distribution review (RDR) where trail commission is no longer paid. However, we understand that it is not always commercially viable to run a class for a small number of investors after the majority have converted voluntarily. In these cases, merging classes to achieve economies of scale is likely to be in the best interests of investors.

The recast version of FG14/4 will be effective from the date of this publication, and is now known as FG18/3.<sup>16</sup> It is presented in Appendix 2 of this document.

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### ***Trail commission***

- 3.8** CP17/18 asked questions for discussion about whether we should continue to allow the payment of trail commission. We received a range of feedback on both sides of the debate. We are grateful to respondents for sending us their views, which will inform our wider consideration of trail commission. We are still considering the issue and have no immediate plans to bring forward proposals for policy change at the moment.

## 4 Ensuring fairer treatment of dealing profits

### Our proposals

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**4.1** In chapter 5 of CP17/18 we set out proposals for fairer treatment of the dealing profits that may arise when AFMs deal as principal in the units of their funds. We found that the managers of some dual-priced authorised funds, by matching the units of incoming and outgoing investors, were making a risk-free profit on the difference between the dealing prices for those matched transactions. We proposed that the profits should be repaid to the fund, for the benefit of investors.

**4.2** In CP17/18 we asked:

**Q15:** *Do you agree with our proposal to allow box profits to be retained by the AFM when they have been earned through an 'at risk' exposure, but not when they are achieved risk-free?*

**Q16:** *Do you have any comments on whether risk-free profits should be passed on to investors in the fund or given back to subscribing / redeeming investors?*

### Feedback received

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**4.3** Over forty respondents to the paper commented on these proposals. Most agreed with us that as a matter of principle, an AFM should not retain dealing profits where there is no risk to its own capital. One respondent observed that the retention of risk-free profits is an example of where the principle of treating customers fairly has failed. However, a number of respondents, especially among those directly involved in managing and administering authorised funds were concerned about the practicalities of implementing our proposal as drafted and some possible unintended consequences.

**4.4** Some said the proposals were likely to be too complex in practice. They pointed out, for example, the difficulty in analysing transactions where there are multiple classes with different pricing bases and differing class conversion factors (for example between income and accumulation units). A number of these respondents concluded it would be simpler and more efficient to adopt single pricing or move to a non-profit-making box model to address the concerns. This would also remove any opportunity to manipulate the rule by treating risk-free profits as being held at risk.

**4.5** Other respondents welcomed our statement that the use of a box can be compatible with acting in the best interests of investors and elaborated on this theme. They noted that the AFM, by dealing as principal, assumes the credit risk if an investor buying units

defaults on the deal, so that the fund does not suffer as a result. While dual pricing ensures transacting investors fully pay any resulting transaction costs, so there is no dilution of the fund's value, it also allows an AFM dealing as principal to set dealing prices to reflect the trend of inflows and outflows. The AFM may choose not to reset its pricing basis on a day when the net transactions are against the prevailing trend, so incurring a loss on its own account to the benefit of some of the investors transacting on that day.

- 4.6** A few respondents thought that we had not sufficiently recognised these relationships between dual pricing, dealing as principal and box management, which explain how dealing profits can arise. They saw this as implying that we do not see a future for dual pricing and might want single pricing to replace it; one respondent suggested that any changes to the treatment of box profits should form part of a wider review of dual and single pricing.
- 4.7** Some respondents, while agreeing with our proposals for risk-free profits, suggested that we had not correctly identified what is risk-free. They pointed out that any reduction in the dealing spread requires the AFM to commit its own capital to hold surplus units, and that in such cases the majority of the benefit from matching deals goes to the transacting investors. They thought the proposed rule would force at-risk profits to be paid to the fund and for payments to be made when there is actually a box loss. They suggested that a rule stating that the manager cannot keep risk-free box profits, without dictating which investors should benefit from such profits, would achieve the policy objective while preserving flexibility.
- 4.8** Views on how to treat the risk-free amounts differed. The majority of respondents who commented on this point thought it would be fairer and more practical to pay the amounts into the fund as we had proposed, recognising the potential difficulty of reallocating amounts to individuals. One said that passing the amounts to funds holding illiquid assets such as property would help manage liquidity and avoid short-termism. A few saw both approaches as acceptable, but some firmly favoured returning the monies to transacting investors, arguing for example that the spread in dual pricing is used to protect continuing investors, not reward them for the transactions carried out by other investors when there is no underlying transaction in the fund portfolio.
- 4.9** Some respondents suggested alternative ways in which the aim of the proposal could be achieved without preventing AFMs from profiting from at-risk unit holdings. One proposed that AFMs could analyse cash flows to assess box activity profits each quarter and pay an appropriate amount to the fund, after deducting the return on the units held over the quarter. Several others also commented on the practical difficulties of having to pay small amounts into the fund on what would typically be a daily basis.
- 4.10** Some people were concerned about how payments into scheme property would affect the fund. Respondents asked how the amounts should be treated for tax and accounting purposes and what should be done with the income element of the unit price. Some thought that these amounts might distort investment performance, making some dual-priced funds look relatively more attractive than their single-priced counterparts, and asked how the adjustments should be treated when calculating a performance fee.
- 4.11** There weren't many comments on our proposals to enhance disclosures in the prospectus about the AFM's approach to box management and retention of dealing



profits. One respondent asked whether other documents, like the key investor information document, should include a statement on this, and how payments should be detailed in the periodic reports and accounts. A trade association respondent said that full transparency on box profits would be important, with disclosure of the amounts paid to the fund and their impact on performance.

- 4.12** Finally, a number of respondents suggested that the six-month transitional period we proposed under-estimates the complexity of the systems and procedural changes needed and asked for more time. These changes will significantly affect the fund administration and accounting functions, which are often outsourced to specialist providers acting for multiple AFMs. One respondent noted that assurances about the longer-term future of dual pricing would be welcome, to give firms confidence to invest in upgrading their systems.

### Our response

We welcome the broad support for our proposal and intend to proceed with it. We are grateful for the detailed technical feedback received and have used this to make some adjustments to improve the final rules and guidance.

We said in the CP that the use of a manager's box can be compatible with acting in the best interests of investors, and that AFMs are entitled to commit their own capital to a fund and participate in its risks and returns. This is still our view.

We have no plans to review the fund pricing regime and we stand by the position we (as the Financial Services Authority (FSA)) set out in PS06/9.<sup>17</sup> Both single pricing and dual pricing have their advantages and drawbacks for fund investors, so we think it is fair to allow the methodologies to co-exist as long as they both continue to provide adequate investor protection and the market determines there is a place for them. We acknowledge the arguments that dual pricing may be especially suitable for some asset classes such as land and property.

The key adjustments we have made in the final rules are:

- to require the AFM not to retain risk-free box profits and to allocate them in a way that is fair to unitholders, while removing the obligation to pay them to the fund; guidance indicates that profits could be allocated fairly by paying them to the fund or to individual investors who have bought and sold units
- to recognise situations where risk-free profits are offset by losses on some transactions, when the dealing spread is narrower than the maximum permitted spread, and
- to change the frequency for making payments to the fund.

<sup>17</sup> PS06/9 Single and dual pricing for authorised collective investment schemes – feedback on CP06/7, October 2006.

We have provided a more detailed technical commentary on the final rules in Annex 2 to help the firms that will need to implement systems and procedural changes.

We recognise that modifying the rule in these ways does not remove all the operational complexities that respondents to the CP noted, and may add to them. We have sought to strike a balance between good outcomes for investors and the operational demands the changes place on firms.

We accept that AFMs and their service providers should be given enough time to prepare for these rule changes, especially as the calculation of the new payments will depend on IT solutions. We do not want to leave AFMs with no option but to discontinue box management, simply because they do not have enough time to design, test and implement new processes. For this reason, we are deferring the commencement date to allow firms 12 months to make the changes.

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## Role of the depositary

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- 4.13** We also explained in the paper that our rule on the duties of depositaries will require them to oversee compliance with the proposed rule changes. In CP17/18 we asked:

**Q17:** *Do you have any comments on our proposed approach to include the proposed changes on risk-free box profits as part of the existing monitoring requirements on depositaries?*

- 4.14** Seventeen respondents commented on this question. They broadly agreed that the proposed changes were compatible with the depositary's current duties, and some thought that there should not be any significant additional burden. However, depositaries commented that it was not clear what level of oversight would be required and outlined some of the possible impacts. They asked whether the FCA envisaged a depositary's duties as covering a daily review or re-performance of the AFM's calculation on its risk-free box profits figures, in which case the impact would be far greater than checks which rely on the AFM's calculation.
- 4.15** Depositaries also noted the potential need to recruit and train additional staff to perform the new tasks, as well as the additional work needed to oversee the unit creation and cancellation process if daily payments are made to the fund. Some other respondents, including some fund managers, shared these concerns and wondered whether an increase in their duties would lead to an increase in fees to cover their additional costs.
- 4.16** Depositaries disagreed with the assertion in our CBA that their additional costs would be minimal. In their view, this is a new requirement rather than an additional element in their existing duty of oversight, which will result in additional costs. The scale of those costs will depend on how much oversight we expect them to undertake.



- 4.17** Some respondents, including consumer representatives, said that in addition to the oversight provided by depositaries, the level of box profits should be considered by the board as part of the value assessment involving the proposed independent directors.

#### Our response

It was not our intention to expand significantly the scope of depositaries' oversight or to make the performance of their current duties more onerous. We believe that the changes we have made to the rule will go some way to reassure depositaries on this point, but for the avoidance of doubt we confirm that we do not expect them to carry out daily checks on whether the AFM has correctly calculated its dealing profits.

It should be sufficient to ensure that the amount determined by the AFM is reflected in the price calculation where it is material, that payments accrued for in the fund valuation are regularly received into the fund's account, and that any rule breaches are recorded in the usual way. We would also expect the depositary to review periodically the AFM's processes relating to this rule, as part of its wider testing of the effectiveness of the AFM's controls over valuation and pricing. Such checks might include sample testing of the calculations performed by the AFM to ensure they are complete and accurate.

AFMs' scrutiny of any dealing profits they make should form part of their wider assessment of how they deliver value to investors, so it would be appropriate for the AFM board to consider the matter.

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## 5 Discussion feedback: extending the scope of our governance proposals to other investment products

- 5.1** This chapter sets out the feedback on the discussion questions in chapter 6 of CP17/18 and gives our response.

### Discussion topics

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- 5.2** In CP17/18 we asked for views on whether we should extend any aspects of our governance proposals for the authorised funds market to other investment products, specifically to unit-linked and with-profits insurance products and investment trusts (also referred to as investment companies<sup>18</sup>).

- 5.3** We said that we did not propose to extend the proposals to pensions, as we would instead consider this as part of our work on non-workplace pensions.

- 5.4** In CP17/18 we asked:

- Q18:** *Are current arrangements, particularly for with-profits business, fit for purpose and can they achieve the same outcomes? If so, please elaborate on how they achieve those outcomes.*
- Q19:** *Would additional or alternative approaches be more appropriate or cost-effective for tackling the same issues? For example, would the independent governance committees set up by life insurers and used for workplace pensions be appropriate for other products as well?*
- Q20:** *What would the costs, challenges and resource implications be for firms if we applied the proposals in Chapter 3 to life insurers?*
- Q21:** *What would the potential benefits be for consumers and firms of introducing any additional governance requirements for unit-linked funds and with-profits business?*
- Q22:** *Would there be a risk of investor harm or disruption to the market if we did not extend our proposals for authorised funds to unit-linked or with-profits business?*
- Q23:** *Do you agree with our proposed approach to pension products?*

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18 Investment trust/companies are corporations listed under Chapter 15 of the Listing Rules whose main business is to act as closed-ended pooled investment vehicles.

**Q24:** *What are your views on whether it would be appropriate and proportionate for the FCA to consider introducing similar rules to those proposed for authorised funds for investment companies?*

**Q25:** *Is there a risk of investor harm or disruption to the market if we do not extend our proposals for authorised funds to investment companies? If so, how would this risk affect investors?*

## Feedback received

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### General

**5.5** We received over 40 responses to our questions in CP17/18 and held discussions with a range of industry participants. Responses supported consistency of governance and oversight across the retail investment market, but noted that this would not necessarily need the same governance structures. Some respondents noted that potential benefits from an extension would include greater transparency and consumer confidence, and lower charges. Other respondents considered that investor harm had not been established to justify an extension and that this could result in duplicating current governance arrangements and increasing costs for firms, and so ultimately consumers.

### Detail

**5.6** For with-profits business, a number of respondents expressed the view that the current arrangements work well, and that our COBS rules replicated the outcomes sought by our governance proposal for authorised funds. However, some disagreed, stating that the opaque nature of with-profits products can lead to hidden charges and poor consumer outcomes.

**5.7** For unit-linked business, some respondents believed that current arrangements were adequate and pointed to a range of factors such as firm governance structures, and the value provided to consumers by insurers as institutional buyers. These respondents also highlighted regulatory requirements such as the role of IGCs over those unit-linked funds in workplace pensions, forthcoming product governance requirements in the Insurance Distribution Directive,<sup>19</sup> and our guidance on the fair treatment of long-standing customers.<sup>20</sup> Other respondents argued that extending the governance proposals to unit-linked funds would be beneficial.

**5.8** Most respondents disagreed with extending the role of IGCs. Some respondents considered that they were a relatively new and untested feature, while others considered that IGCs were put in place for a specific purpose and product set (workplace pensions) and that this had not been justified for unit-linked and with-profits business.

**5.9** For investment trusts, a respondent said that the governance arrangements already delivered what we were aiming for with authorised funds. This respondent noted that investment trust governing bodies are required under FCA listing rules to have

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<sup>19</sup> <https://www.fca.org.uk/publications/policy-statements/ps18-1-insurance-distribution-directive-implementation-feedback-and-near-final-rules>

<sup>20</sup> <https://www.fca.org.uk/publications/finalised-guidance/fair-treatment-long-standing-customers-life-insurance-sector>



a majority of independent directors. The respondent said that an investment trust governing body cannot be outranked or controlled by the external asset manager entity they have appointed, and can choose to appoint another manager if necessary. The respondent also noted that the investors in the 'funds' (the trusts) are the trusts' shareholders and that as such investment trust governing bodies are not conflicted. The respondent was not supportive of extending the governance proposals in CP17/18 Chapter 3 to investment trusts.

**5.10** Most respondents agreed with our proposal to look at whether we should be doing more to consider governance as part of the work we have committed to on non-workplace pensions. A few respondents felt that it would be better to consider all of these products together and have a common view and common requirements.

**5.11** Other options suggested by respondents were:

- updating the Association of British Insurers (ABI) guide to good practice for unit-linked funds<sup>21</sup> and for the FCA to join the ABI's unit-linked working group
- the FCA developing further guidance on value for money
- the FCA to undertake further work on unit-linked products to demonstrate adverse outcomes exist
- an extension of the concept of the with-profits committee to other types of products

### Our response

As we stated in CP17/18, while the AMMS did not focus on unit-linked or with-profits business, concerns highlighted by that work around value for money and governance in authorised funds may also exist for these types of retail investment products and similar theories of harm may be relevant.

We have ongoing diagnostic work into with-profits and unit-linked products that will improve our view of any harm that exists in these markets. Once this work has concluded later this year, we will decide whether further intervention in relation to unit-linked and with-profits products is required, and the most appropriate way for us to do this. We expect to communicate a view on this in the first half of 2019.

As our diagnostic work will give us a clearer view on whether harm exists in these markets, we do not consider it is appropriate to provide further guidance on value for money or to consider the wider application of with-profits committees at this time. We will continue to engage with industry stakeholders on these issues as our work progresses during the course of this year.

21 <https://www.abi.org.uk/globalassets/sitecore/files/documents/publications/public/2014/conduct/abi-guide-to-good-practice-for-unit-linked-funds.pdf>



We are keeping the possibility of further changes to investment trust governance arrangements under review, but we do not plan any immediate action on this.

Given the feedback received, we are not bringing forward proposals on extending the governance proposals to pensions at this time, but we will continue to consider these issues as part of our work on non-workplace pensions.

---

## Annex 1

### List of non-confidential respondents

Allianz Global Investors

Artemis

Arthur J Gallagher

Association of British Insurers

Association of Financial Mutuals

B&CE

Baillie Gifford

Bank of New York Mellon

Barnett Waddingham

BlackRock

BPH Wealth Management

Brian Shearing & Partners

Castle Investments

CFA Society UK

Chapters Financial

DMS Governance

DPI Financial Services

DST Systems

Equitle Investments

Eversheds Sutherland

Excalibur

Family Finance Centre Group

FCA Practitioner Panel



Financial Inclusion Centre

Financial Services Consumer Panel

FK Financial

Hermes Investment Management

Institute & Faculty of Actuaries

Investment & Life Assurance Group

Jackson Hodge Wealth Management Services

JLT Employee Benefits

JP Morgan Asset Management

Jupiter Asset Management

Liontrust Asset Management

M&G Investment Management

Majedie Asset Management

Mr Martin Pagett

New City Initiative

Old Mutual

Orbis

Pensions & Lifetime Savings Association

Personal Investment Management & Financial Advice Association (PIMFA)

Philip J Milton & Company

Positive Wealth Creation

Principles for Responsible Investment

RGA IFA

Mr Roger Morton

Royal London Asset Management

Sarasin Investment Funds

SCM Direct

Scottish Widows

Securities Industry & Financial Markets Association

ShareAction

St James's Place

State Street Global Advisors

Mr Stewart Cazier

Strathayr Financial Services

The 100 Group Pensions Committee

The Association of Investment Companies

The Depositary and Trustee Association

The Investment Association

The Online Partnership

The Society of Pension Professionals

UK Sustainable Investment and Finance Association

Wesleyan

Willis Owen

## Annex 2

# Commentary on risk-free box profits rules and guidance

1. As noted in Chapter 4, the following commentary explains in more detail the rationale for the final rules on risk-free box profits and the effect we expect them to have on firms' unit dealing processes.
2. We have taken account of comments about some of the likely consequences of the proposal to identify risk-free profits and pay them into scheme property. We have redrafted COLL 6.3.5DR so it requires the AFM (and its associates) to make sure they do not profit from risk-free matching of unit sales and redemptions. The revised drafting acknowledges that any preliminary charge or redemption charge due to the AFM is not affected by this rule.
3. Although the draft rule would have achieved its purpose where the AFM charges the maximum permitted dealing spread between the sale and redemption prices, it might have had unintended consequences where the AFM sets a narrower dealing spread than the maximum amount permitted. When this happens, the AFM is returning an element of the spread to the transacting investors, instead of taking it as profit. Just as the AFM can make a same-day profit free of market risk by matching deals, it can make a same-day loss on unmatched deals either by selling units below issue price which it then has to create to satisfy demand, or by redeeming units at a price above cancellation price and then immediately cancelling the surplus.
4. The draft rule considered only the difference between the sale and redemption prices of units in matched deals, and not whether those prices differ from the maximum permitted prices or whether the AFM is incurring losses through the narrower spread. The draft rule would cause the AFM to make payments to the fund where it has already given up profits or even made an overall loss on box transactions at that valuation point.
5. We accept that it would be unsatisfactory if our rules disincentivised AFMs from offering investors narrower dealing spreads. An AFM that sets dealing spreads to the advantage of transacting investors should not be penalised for doing so, compared to one that charges the maximum possible spread between sales and redemptions.
6. To address this point, we have expanded COLL 6.3.5DR to recognise situations where the AFM's risk-free profit made on matched sales and redemptions is offset by a loss on certain sales and redemptions. Specifically, the rule amendment should allow a loss to be recognised where:
  - unmatched units from sales must be met by creation of new units, when the creation (issue) price is above offer (sale) price
  - unmatched units from repurchases are cancelled immediately and not held on the box, when bid (redemption) price is above cancellation price

7. The effects of the rule are that:
- a. losses on sales cannot be offset if it would have been possible to cover the sale from units held on the box or redeemed at the same valuation point (this is purely for the purpose of calculating the amount due to the fund under this rule; it does not prescribe how the AFM actually chooses to allocate old and new units from the box)
  - b. the amount of profit the AFM must give up is not reduced to take account of any adjustments made to correct dealing errors relating to previous valuation points
  - c. where the offsetting of losses against risk-free profit results in an overall box loss, this loss cannot be carried forward to offset a net risk-free profit on day two and reduce the amount the AFM must give up – it must be reset to zero after each valuation point
8. The amended rule is not intended either to force the AFM to set a narrower dealing spread, or on the other hand to protect it from ever suffering a loss. However, it should treat AFMs more equitably when they commit their own capital to the box by assuming at-risk positions and setting dealing spreads to benefit the investor over the AFM itself.
9. Although the final rules do not require payment of a sum into the fund to represent the risk-free profit, we still think this is one way of fairly allocating any amount not returned to investors through a narrower dealing spread. We have added guidance in COLL 6.3.5EG (2) to cover this point while indicating that alternatives are possible.
10. We have reconsidered the proposed requirement for risk-free profits to be paid into scheme property at the same frequency as the fund is dealt. We have added guidance that these payments could be aligned with payments out of scheme property for fees and expenses due to the AFM and other parties. Thus, the relevant amount should in principle be accrued in each price calculation, but for administrative purposes the actual transfer of cash might take place on a periodic basis, typically monthly.
11. We recognise that calculating and accruing for the exact amount of risk-free profit may be complex and the additional process should not delay the AFM from calculating and publishing unit prices, especially when the fund offers daily dealing. So, we have added guidance at COLL 6.3.5EG (4) that the unit price calculation should include an accrual for the AFM's reasonable estimate of the total payment due to the fund at that point, where it is sufficiently material to affect the unit price to the fourth significant figure. This estimate should be regularly adjusted once the final calculation for preceding valuation points has been made.
12. We have not identified any issues affecting the treatment of these payments for tax or accounting purposes that should be addressed through Handbook rules or guidance. The monies represent an element of the capital subscribed by investors, which has passed through the AFM as principal instead of being paid directly to the fund. The treatment of these monies within the portfolio should follow accordingly. As the difference between a bid price and an offer price is a capital difference, we do not think the treatment of any income accrued in the unit price will be adversely affected by the rule change.
13. For similar reasons, we have not added further rules or guidance on investment performance records or performance fees. The new rule's effect is to move the fund closer to the position it would be in if the AFM chose to deal as agent for the



fund, rather than as principal. In that case, any difference in the dealing spread would automatically pass to the fund, which would not be seen as a distortion of its performance. As for performance fees, it is for the AFM to work out how to calculate them fairly for investors, and we will consider this when reviewing the effect of our rule changes.

- 14.** We are proceeding with the rules on disclosure, subject to some minor drafting changes. Regarding the information to be provided in periodic manager's reports and accounts, the Statement of Recommended Practice (SORP) for authorised funds might need to be amended to take account of payments of risk-free box profits into scheme property.



## Annex 3

### Abbreviations used in this paper

<b>ABI</b>	Association of British Insurers
<b>AFM</b>	authorised fund manager
<b>AIFM</b>	Alternative Investment Fund Managers (Directive 2011/61/EU)
<b>AMMS</b>	asset management market study
<b>AUM</b>	assets under management
<b>CBA</b>	cost benefit analysis
<b>COBS</b>	Conduct of Business sourcebook
<b>COCON</b>	Code of Conduct sourcebook
<b>COLL</b>	Collective Investment Schemes sourcebook
<b>CP</b>	consultation paper
<b>EEA</b>	European Economic Area
<b>FCA</b>	Financial Conduct Authority
<b>FG</b>	final guidance
<b>FSA</b>	Financial Services Authority
<b>IDWG</b>	institutional disclosure working group
<b>IGC</b>	independent governance committee
<b>MiFID II</b>	the recast Markets in Financial Instruments Directive (2014/65/EU)
<b>NED</b>	non-executive director
<b>PR</b>	prescribed responsibility
<b>PRIIPs</b>	Packaged Retail and Insurance-based Investment Products (Regulation EU 1286/2014)
<b>PS</b>	policy statement

<b>RDR</b>	retail distribution review
<b>SM&amp;CR</b>	senior managers and certification regime
<b>SORP</b>	statement of recommended practice
<b>SYSC</b>	Senior Management Arrangements, Systems and Controls sourcebook
<b>UCITS</b>	Undertakings for Collective Investment in Transferable Securities (Directive 2009/65/EC)
<b>VfM</b>	value for money

We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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# Appendix 1

## Made rules (legal instrument)

**COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK (MISCELLANEOUS  
AMENDMENTS) INSTRUMENT 2018**

**Powers exercised**

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in or under:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
    - (a) section 137A (The FCA’s general rules);
    - (b) section 137T (General supplementary powers);
    - (c) section 139A (Power of the FCA to give guidance);
    - (d) section 247 (Trust scheme rules);
    - (e) section 248 (Scheme particulars rules);
    - (f) section 261I (Contractual scheme rules);
    - (g) section 261J (Contractual scheme particulars rules); and
  - (2) regulation 6(1) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

**Commencement**

- C. Part 1 of the Annex to this instrument comes into force on 1 April 2019 and Part 2 of the Annex to this instrument comes into force on 30 September 2019.

**Amendments to the Handbook**

- E. The Collective Investment Schemes sourcebook (COLL) is amended in accordance with the Annex to this instrument.

**Citation**

- F. This instrument may be cited as the Collective Investment Schemes Sourcebook (Miscellaneous Amendments) Instrument 2018.

By order of the Board  
22 March 2018

## Annex

## Amendments to the Collective Investment Schemes sourcebook (COLL)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## Part 1: Comes into force 1 April 2019

## 4 Investor Relations

...

## 4.2 Pre-sale notifications

...

Table: contents of the prospectus

4.2.5 R This table belongs to *COLL* 4.2.2R (Publishing the prospectus).

...

Dealing			
17	The following particulars		
	...		
	(h)	in a <i>prospectus</i> available during the period of any initial offer:	
		...	
		(vi)	any other relevant details of the <i>initial offer</i> ; <del>and</del>
	(i)	whether a <i>unitholder</i> may effect transfer of title to <i>units</i> on the authority of an <i>electronic communication</i> and if so the conditions that must be satisfied in order to effect a transfer; <u>and</u>	
	(j)	<u>if the <i>authorised fund manager</i> deals as principal in <i>units</i> of the <i>scheme</i> and holds them for that purpose, a statement of its policy for doing so and, where applicable:</u>	
		(i)	<u>a description of when the <i>authorised fund manager</i> may retain any profits it earns and absorb any losses it incurs for these activities; and</u>
		(ii)	<u>a statement of non-accountability as referred to in <i>COLL</i> 6.7.16G.</u>

...

...

Guidance on contents of the prospectus

4.2.6 G ...

- (3) ~~In relation to COLL 4.2.5R(27), the *prospectus* might include a statement of the *authorised fund manager's* policy in relation to holding *units* in the *scheme* as *principal*, and in particular whether it seeks to make a profit from doing so. It might also include a prominent statement of non-accountability referred to in COLL 6.7.16G (Exemptions from liability to account for profits).~~ [deleted]

...

...

## 6 Operating duties and responsibilities

...

### 6.3 Valuation and pricing

...

Profits from dealing as principal

6.3.5D R (1) Where an *authorised fund manager (AFM)*:

- (a) accepts instructions to *sell* and *redeem units* as *principal*; and
- (b) is able to execute a *sale* instruction by *selling units* it has *redeemed* at the same *valuation point*, without placing its own capital at risk,

subject to (2), the *AFM* must not retain for its own account, or the account of any of its *associates*, the difference between the *price* at which a *unit* was *redeemed* (before deduction of any *redemption charge*) and the *price* at which the same *unit* was sold (after deduction of any *preliminary charge*). Any such difference must be allocated in a way that is fair to *unitholders*.

- (2) In calculating the profit arising under (1), the *AFM* may offset any loss it incurs at the same *valuation point*, calculated in accordance with (3) below, when dealing as *principal* in relation to:

- (a) a *unit* issued at that *valuation point* to fulfil a *sale* instruction that cannot be matched against any *redeemed unit* or any other *unit* of that *class* held by the *manager* as *principal*; and

- (b) a unit redeemed and cancelled at that valuation point.
- (3) The amount of the loss referred to in (2) is:
  - (a) for units issued in accordance with (2)(a), the difference between the issue price of a unit and the sale price of that unit, less any preliminary charge;
  - (b) for units cancelled in accordance with (2)(b), the difference between the cancellation price of a unit and the redemption price of that unit, before any redemption charge is applied.
- (4) Where any loss arising under (2) is greater than any profit arising under (1), that loss cannot be offset against any profit arising at a subsequent valuation point.
- (5) This rule applies to the redemption and sale of units of different classes at the same valuation point, if those classes are treated as one for the purpose of COLL 6.2.6AR.

- 6.3.5E      G      (1) The authorised fund manager may commit its own capital to hold units for the purpose of dealing as principal and may seek to profit from gains in the value of the units it holds, when it issues or redeems units at one valuation point then sells or cancels them at a later valuation point. However, it should not profit from situations in which it is not exposed to an equal risk of loss if the units fall in value, or from the ability to match simultaneous sales and redemptions at different prices at no risk to its own capital.
- (2) The AFM may allocate any amount arising under COLL 6.3.5DR(1) in the interests of investors by paying it into scheme property for the benefit of all unitholders. Alternatively, the AFM may redistribute it individually among the transacting investors.
- (3) Where the AFM intends to allocate a payment to scheme property, it should determine if the amount (when added to any other amounts of the same kind relating to that class of units) would, if taken into account in the scheme's valuation, affect the accuracy of the unit prices to four significant figures. If so, and subject to (4) below, the amount should be accrued in each subsequent valuation of the scheme until the payment is transferred. Such payments into scheme property should be made regularly and no less frequently than payments for the AFM's management charge are transferred out of scheme property.
- (4) The calculation to be performed under COLL 6.3.5DR should be carried out in relation to each valuation point of the scheme on a timely basis. Where it is not practical to do this before unit prices are calculated and published, the AFM should ensure that the accrual represents a reasonable estimate of the total payment it intends to

make to scheme property.

...

## 6.7 Payments

...

Exemptions from liability to account for profits

- 6.7.16 G ~~An~~ Except as provided in COLL 6.3.5DR, an *affected person* is not liable to account to another *affected person* or to the *unitholders* of any *scheme* for any profits or benefits it makes or receives that are made or derived from or in connection with:

...

...

## 8 Qualified investor schemes

...

### 8.3 Investor relations

...

Table: contents of qualified investor scheme prospectus

- 8.3.4 R This table belongs to COLL 8.3.2R.

...		
13	<b>Dealing</b>	
	Details of:	
	...	
	(9)	the circumstances in which direct <i>issue</i> or <i>cancellation</i> of <i>units</i> by the <i>ICVC</i> or the <i>depository</i> of an <i>AUT</i> or <i>ACS</i> (as appropriate) may occur and the relevant procedures for such <i>issues</i> and <i>cancellations</i> ; <del>and</del>
	(10)	whether a <i>unitholder</i> may effect transfer of title to <i>units</i> on the authority of an <i>electronic communication</i> and if so the conditions that must be satisfied in order to effect a transfer; <u>and</u>
	(11)	<u>if the <i>authorised fund manager</i> deals as principal in <i>units</i> of the <i>scheme</i> and holds them for that purpose, a statement of its policy for doing so and, where applicable:</u>



		(a)	<u>a description of when the <i>authorised fund manager</i> may retain any profits it earns and absorb any losses it incurs for these activities; and</u>
		(b)	<u>a statement of non-accountability as referred to in <i>COLL 8.5.14G</i>.</u>
...			

...

## 8.5 Powers and responsibilities

...

### 8.5.9 ...

#### Profits from dealing as principal

#### 8.5.9-B R (1) Where an *authorised fund manager*:

- (a) accepts instructions to *sell* and *redeem units* as *principal*; and
- (b) is able to execute a *sale* instruction by *selling units* it has *redeemed* at the same *valuation point*, without placing its own capital at risk,

subject to (2), the *AFM* must not retain for its own account, or the account of any of its *associates*, the difference between the *price* at which a *unit* was *redeemed* (before deduction of any *redemption charge*) and the *price* at which the same *unit* was sold (after deduction of any *preliminary charge*). Any such difference must be allocated in a way that is fair to *unitholders*.

- (2) In calculating the profit arising under (1), the *AFM* may offset any loss it incurs at the same *valuation point*, calculated in accordance with (3), when dealing as *principal* in relation to:

- (a) a *unit* issued at that *valuation point* to fulfil a *sale* instruction that cannot be matched against any *redeemed unit* or any other *unit* of that *class* held by the *manager* as *principal*; and
- (b) a *unit* *redeemed* and *cancelled* at that *valuation point*.

- (3) The amount of the loss referred to in (2) is:

- (a) for *units* issued in accordance with (2)(a), the difference between the *issue price* of a *unit* and the *sale price* of that *unit*, less any *preliminary charge*;
- (b) for *units* *cancelled* in accordance with (2)(b), the difference between the *cancellation price* of a *unit* and the *redemption*

price of that unit, before any redemption charge is applied.

- (4) Where any loss arising under (2) is greater than any profit arising under (1), that loss cannot be offset against any profit arising at a subsequent valuation point.
- (5) This rule applies to the redemption and sale of units of different classes at the same valuation point, if those classes are treated as one for the purpose of COLL 8.5.10AR.

- 8.5.9-A    G    (1)    The authorised fund manager may commit its own capital to hold units for dealing as principal and may seek to profit from gains in the value of the units it holds, when it issues or redeems units at one valuation point then sells or cancels them at a later valuation point. However, it should not profit from situations in which it is not exposed to an equal risk of loss if the units fall in value, or from the ability to match simultaneous sales and redemptions at different prices at no risk to its own capital.
- (2)    The AFM may allocate any amount arising under COLL 8.5.9-BR(1) in the interests of investors by paying it into scheme property for the benefit of all unitholders. Alternatively, the AFM may redistribute it individually among the transacting investors.
- (3)    Where the AFM intends to allocate a payment to scheme property, it should determine if the amount (when added to any other amounts of the same kind relating to that class of units) would, if taken into account in the scheme's valuation, affect the accuracy of the unit prices to four significant figures. If so, and subject to (4) below, the amount should be accrued in each subsequent valuation of the scheme until the payment is transferred. Such payments into scheme property should be made regularly and no less frequently than payments for the AFM's management charge are transferred out of scheme property.
- (4)    The calculation to be performed under COLL 8.5.9-BR should be carried out in relation to each valuation point of the scheme on a timely basis. Where it is not practical to do this before unit prices are calculated and published, the AFM should ensure that the accrual represents a reasonable estimate of the total payment it intends to make to scheme property.

Maintaining the value of a short-term money market fund

8.5.9A    R    ...

...

Exemptions from liability to account for profits

8.5.14    G    ~~An~~ Except as provided in COLL 8.5.9-BR, an affected person is not liable to account to another affected person or to the unitholders of any scheme for

any profits or benefits it makes or receives that are made or derived from or in connection with:

...

...

## Part 2: Comes into force 30 September 2019

### 4 Investor Relations

...

### 4.5 Reports and accounts

...

Contents of the annual long report

#### 4.5.7 R ...

(5) An annual long report of a *UCITS scheme* which is a *feeder UCITS* must also include:

(a) a statement on the aggregate ~~charges~~ of the payments out of *scheme property* as set out in the *prospectus* (in this rule “charges”) of the *feeder UCITS* and the *master UCITS*; and

...

...

(8) An annual long report of an *authorised fund* must also contain a statement setting out a description of the assessment of value required by *COLL* 6.6.20R including:

(a) a separate discussion and conclusion for the matters covered in each paragraph of *COLL* 6.6.21R, and for each other matter that formed part of the assessment, covering the considerations taken into account in the assessment, a summary of its findings and the steps undertaken as part of or as a consequence of the assessment;

(b) an explanation for any case in which benefits from economies of scale that were identified in the assessment have not been passed on to *unitholders*;

(c) an explanation for any case in which *unitholders* hold *units* in a *class* that is subject to higher charges than those applying to

other classes of the same scheme with substantially similar rights;

(d) the conclusion of the authorised fund manager's assessment of whether the charges are justified in the context of the overall value delivered to the unitholders in the scheme; and

(e) if the assessment has identified that the charges are not justified in the context of the overall value delivered to the unitholders, a clear explanation of what action has been or will be taken to address the situation.

(9) An AFM need not include the statement required by (8) in its annual long report if it makes the statement available to unitholders annually in a composite report covering two or more of the authorised funds it manages, published in the same manner as the annual long report.

4.5.7A G ...

(5) An AFM which is not subject to COLL 6.6.20R as a result of COLL 6.6.19R is not required to comply with COLL 4.5.7R(8) or (9).

...

## 6 Operating duties and responsibilities

...

### 6.6 Powers and duties of the scheme, the authorised fund manager, and the depositary

...

Table of application

6.6.2 R This table belongs to COLL 6.6.1R.

<i>Rule</i>	<i>ICVC</i>	<i>ACD</i>	<i>Any other directors of an ICVC</i>	<i>Depositary of an ICVC</i>	<i>Authorised fund manager of an AUT or ACS</i>	<i>Depositary of an AUT or ACS</i>
6.6.18G	...					
<u>6.6.19R</u>		<u>x</u>	<u>x</u>		<u>x</u>	
<u>6.6.20R</u>		<u>x</u>	<u>x</u>		<u>x</u>	
<u>6.6.21R</u>		<u>x</u>	<u>x</u>		<u>x</u>	

<u>6.6.22G</u>		<u>x</u>	<u>x</u>		<u>x</u>	
<u>6.6.23E</u>		<u>x</u>	<u>x</u>		<u>x</u>	
<u>6.6.24G</u>		<u>x</u>	<u>x</u>		<u>x</u>	
<u>6.6.25R</u>		<u>x</u>	<u>x</u>		<u>x</u>	
<u>6.6.26G</u>		<u>x</u>	<u>x</u>		<u>x</u>	
Notes:	...					
	(5)	<u>COLL 6.6.20R to COLL 6.6.26G have a special application as set out in COLL 6.6.19R.</u>				

...

Application of assessment of value and independent director rules

6.6.19 R COLL 6.6.20R to COLL 6.6.26G apply to:

- (1) an authorised fund manager (other than an EEA UCITS management company or an EEA AIFM) of an AUT, ACS or ICVC; and
- (2) a UK UCITS management company providing collective portfolio management services for an EEA UCITS scheme from a branch in another EEA State or under the freedom to provide cross border services.

Assessment of value

- 6.6.20 R (1) An authorised fund manager must conduct an assessment at least annually for each scheme it manages of whether the payments out of scheme property set out in the prospectus are justified in the context of the overall value delivered to unitholders.
- (2) In carrying out the assessment required by (1), the AFM must, separately for each class of units in a scheme, consider at least the matters set out in COLL 6.6.21R (Table: minimum considerations – assessment of value).

Table: minimum considerations – assessment of value

6.6.21 R This table belongs to COLL 6.6.20R (Assessment of value).

<u>Quality of service</u>	
(1)	<u>The range and quality of services provided to unitholders.</u>
<u>Performance</u>	

(2)	The performance of the <i>scheme</i> , after deduction of all payments out of <i>scheme property</i> as set out in the <i>prospectus</i> (in this rule, <i>COLL 6.6.23E</i> and <i>COLL 8.5.19E</i> , “charges”). Performance should be considered over an appropriate timescale having regard to the <i>scheme’s</i> investment objectives, policy and strategy.
<b><u>AFM costs - general</u></b>	
(3)	In relation to each charge, the cost of providing the service to which the charge relates, and when money is paid directly to <i>associates</i> or external parties, the cost is the amount paid to that <i>person</i> .
<b><u>Economies of scale</u></b>	
(4)	Whether the <i>AFM</i> is able to achieve savings and benefits from economies of scale, relating to the direct and indirect costs of managing the <i>scheme property</i> and taking into account the value of the <i>scheme property</i> and whether it has grown or contracted in size as a result of the <i>sale</i> and <i>redemption</i> of <i>units</i> .
<b><u>Comparable market rates</u></b>	
(5)	In relation to each service, the market rate for any comparable service provided:
(a)	by the <i>AFM</i> ; or
(b)	to the <i>AFM</i> or on its behalf, including by a <i>person</i> to which any aspect of the <i>scheme’s</i> management has been delegated.
<b><u>Comparable services</u></b>	
(6)	In relation to each separate charge, the <i>AFM’s</i> charges and those of its <i>associates</i> for comparable services provided to <i>clients</i> , including for institutional mandates of a comparable size and having similar investment objectives and policies;
<b><u>Classes of units</u></b>	
(7)	Whether it is appropriate for <i>unitholders</i> to hold <i>units</i> in <i>classes</i> subject to higher charges than those applying to other <i>classes</i> of the same <i>scheme</i> with substantially similar rights.

6.6.22      G      When assessing the quality of service provided under *COLL 6.6.21R(1)*:

- (1)      the *AFM* should have regard to the quality of service it provides and the quality of service provided by any *person* to which any aspect of the *scheme’s* management has been delegated or which provides services to the *AFM* or on its behalf; and
- (2)      the *AFM’s* assessment of quality of service is not confined to

services provided directly to *unitholders* but may include services undertaken on their behalf by the *AFM*, such as consideration of the quality of the investment process used to make decisions about managing the *scheme property*.

- 6.6.23     E     Failure by an *AFM* to take sufficient steps to address any instance where a *scheme's* charges are not justified in the context of the overall value delivered to *unitholders* may be relied on as tending to establish contravention of *COLL* 6.6A.2R, *COBS* 2.1.1R or *COBS* 2.1.4R as applicable.
- 6.6.24     G     (1)     *COLL* 6.6A.2R applies to *AFMs* of *UCITS schemes* and in broad terms requires *AFMs* to act in the best interests of *unitholders*. In particular, *COLL* 6.6A.2R(1) requires *AFMs* to ensure *unitholders* are treated fairly, *COLL* 6.6A.2R(5) requires *AFMs* to act in such a way as to prevent undue costs being charged to any *scheme* it manages and its *unitholders* and *COLL* 6.6A.2R(6)(b) requires an *AFM* to act solely in the interests of the *scheme* and its *unitholders*.
- (2)     *COBS* 2.1.1R is the *clients best interests rule*, *COBS* 2.1.4R(2) requires a *full-scope UK AIFM* to act in the best interests of the *AIF* it manages or the investors of the *AIF* it manages and the integrity of the market and *COBS* 2.1.4R(3) requires the *AFM* to treat all investors fairly.

#### Independent directors

- 6.6.25     R     (1)     An *authorised fund manager* must ensure that at least one quarter of the members of its *governing body* are independent natural *persons*. If the *AFM's governing body* comprises fewer than eight members, the *AFM* must instead ensure that at least two of its members are independent natural *persons*.
- (2)     The *authorised fund manager*, in appointing an independent member of its *governing body*, must determine whether such a member is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, that member's judgement.
- (3)     The *authorised fund manager* must take reasonable steps to ensure that independent members appointed to its *governing body* have sufficient expertise and experience to be able to make judgements on whether the *AFM* is managing each *scheme* in the best interests of *unitholders*.
- (4)     (a)     Independent members of an *AFM's governing body* must be appointed for terms of no longer than five years, with a cumulative maximum duration of ten years.
- (b)     If an independent member is appointed to more than one *governing body* within an *AFM's group*, the cumulative

maximum duration of ten years referred to in (a) is calculated by adding the durations of each separate appointment and discounting periods during which appointments overlapped to avoid double counting.

(c) In relation to a *person* who served as an independent director of an *AFM's governing body* before 1 October 2019, the five year term(s) and cumulative maximum duration of ten years run from that date.

(5) Independent members are not eligible for reappointment to an *AFM's governing body* until five years have elapsed from the end of the ten year period referred to in (4).

(6) The terms of *employment* on which independent members are appointed must be such as to secure their independence.

6.6.26 G (1) The role of the independent members should include providing input and challenge as part of the *AFM's* assessment of value in accordance with *COLL* 6.6.20R. Independent members may be tasked with additional responsibilities, taking into consideration remuneration and conflict of interest *rules*.

(2) A member of an *AFM's governing body* is unlikely to be considered independent if any of the following circumstances exist:

(a) the *person* is an *employee* of the *AFM* or of an *affiliated company* or paid by them for any role (other than as an independent member of the *governing body* of an *affiliated company* or of a body exercising an independent governance function within the *AFM's* group) including participating in the *AFM's* share option or performance-related pay scheme; or

(b) the *person* has been an *employee* of the *AFM* or of an *affiliated company* within the *AFM's* group (other than having been an independent member of the *governing body* of an *affiliated company* or of a body exercising an independent governance function within the *AFM's* group) or of any *person* to which *collective portfolio management* of the *scheme* has been delegated, within the five years preceding their appointment to the *governing body*; or

(c) the *person* has, or had within the three years preceding their appointment, a material business relationship of any description with the *AFM* or with an *affiliated company* or with any *person* to which *collective portfolio management* of the *scheme* has been delegated, either directly or indirectly; or

(d) the *person* has received any sort of remuneration from the



AFM's group (other than as an independent member of the governing body of an affiliated company of the AFM or of a body exercising an independent governance function within the AFM's group) within the five years preceding their appointment; or

(e) the person has a close relative who is an officer or other senior employee of the AFM or a company within the AFM's group.

(3) The expertise and experience required under COLL 6.6.25R(3) may have been gained through professional experience, public service, academia or otherwise, and does not need to relate to the financial services industry.

(4) The effect of COLL 6.6.25R(6) is that a person who serves on the governing body should be subject to appropriate contractual terms so that, when acting in the capacity of an independent member of the governing body, they are free to act in the interests of unitholders and should be able to do so without breaching their terms of employment.

(5) An AFM should fill any vacancies that arise within the required number of independent members on its governing body as soon as possible and, in any event, within six months.

(6) An AFM should consider indemnifying the independent members of its governing body against liabilities incurred while fulfilling their duties as such members.

...

## 7 Suspension of dealings and termination of authorised funds

...

### 7.3 Winding up a solvent ICVC and terminating or winding up a sub-fund of an ICVC

...

Consequences of commencement of winding up or termination

7.3.6 R ...

(2) Once winding up or termination has commenced:

(a) COLL 6.2 (Dealing), COLL 6.3 (Valuation and pricing), COLL 6.6.20R to COLL 6.6.24G (Assessment of value) and COLL 5 (Investment and borrowing powers) cease to apply to the ICVC or to the units and scheme property in the case of

a *sub-fund*;

...

...

...

## **7.4 Winding up an AUT and terminating a sub-fund of an AUT**

...

When an AUT is to be wound up or a sub-fund terminated

- 7.4.3 R (1) Upon the happening of any of the events or dates referred to in (2) and not otherwise:
- (a) *COLL 6.2 (Dealing), COLL 6.3 (Valuation and pricing), COLL 6.6.20R to COLL 6.6.24G (Assessment of value) and COLL 5 (Investment and borrowing powers) cease to apply to the AUT or to the units and scheme property in the case of a sub-fund;*

...

...

...

## **7.4A Winding up a solvent ACS and terminating a sub-fund of a co-ownership scheme**

...

When an ACS is to be wound up or a sub-fund of a co-ownership scheme terminated

- 7.4A.4 R (1) Upon the happening of any of the matters or dates referred to in (3), and subject to the requirement of (4) being satisfied, and not otherwise:
- (a) *COLL 6.2 (Dealing), COLL 6.3 (Valuation and pricing), COLL 6.6.20R to COLL 6.6.24G (Assessment of value) and COLL 5 (Investment and borrowing powers) cease to apply to the ACS or to the units and scheme property in the case of a sub-fund of a co-ownership scheme;*

...

...

...

## 8 Qualified investor schemes

...

### 8.3 Investor relations

...

Contents of the annual report

8.3.5A R ...

- (5) An annual report of an *authorised fund* must also contain a statement setting out a description of the value for money assessment required by COLL 8.5.17R including:
- (a) a separate discussion and conclusion for the matters covered in each paragraph of COLL 6.6.21R, and for each other matter that formed part of the assessment, covering the considerations taken into account in the assessment, a summary of its findings and the steps undertaken as part of or as a consequence of the assessment;
  - (b) an explanation for any case in which benefits from economies of scale that were identified in the assessment have not been passed on to *unitholders*;
  - (c) an explanation for any case in which *unitholders* hold *units* in a *class* for which the payments out of *scheme property* in relation to that *class* as set out in the *prospectus* (in this rule, “charges”) are higher than those applying to other *classes* of the same *scheme* with substantially similar rights;
  - (d) the conclusion of the *authorised fund manager’s* assessment of whether the charges are justified in the context of the overall value delivered to the *unitholders* in the *scheme*; and
  - (e) if the assessment has identified that the charges are not justified in the context of the overall value delivered to the *unitholders*, a clear explanation of what action has been or will be taken to address the situation.
- (6) An *AFM* need not include the information required by (5) in its annual report if it makes the information available to *unitholders* annually in a composite report covering two or more of the *schemes* it manages, published in the same manner as the annual report.

...

### 8.5 Powers and responsibilities

...

Application of assessment of value and independent director rules

- 8.5.16     R     *COLL 8.5.17R to COLL 8.5.21G apply to an authorised fund manager (other than an EEA AIFM) of an AUT, ACS or ICVC.*

Assessment of value

- 8.5.17     R     (1)     *An authorised fund manager must conduct an assessment at least annually for each scheme it manages of whether the payments out of scheme property set out in the prospectus are justified in the context of the overall value delivered to unitholders.*
- (2)     *In carrying out the assessment required by (1), the AFM must, separately for each class of units in a scheme, consider at least the matters set out in COLL 6.6.21R (Table: minimum considerations – assessment of value).*
- 8.5.18     G     *The guidance in COLL 6.6.22G applies to interpreting the requirements of COLL 6.6.21R as applied by COLL 8.5.17R.*
- 8.5.19     E     *Failure by an AFM to take sufficient steps to address any instance where a scheme's charges are not justified in the context of the overall value delivered to unitholders may be relied on as tending to establish contravention of COLL 6.6A.2R, COBS 2.1.1R or COBS 2.1.4R as applicable.*

Independent directors

- 8.5.20     R     (1)     *An authorised fund manager must ensure that at least one quarter of the members of its governing body are independent natural persons. If the AFM's governing body comprises fewer than eight members, the AFM must instead ensure that at least two of its members are independent natural persons.*
- (2)     *The authorised fund manager, in appointing an independent member of its governing body, must determine whether such a member is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, that member's judgement.*
- (3)     *The authorised fund manager must take reasonable steps to ensure that independent members appointed to its governing body have sufficient expertise and experience to be able to make judgements on whether the AFM is managing each scheme in the best interests of unitholders.*
- (4)     (a)     *Independent members of an AFM's governing body must be appointed for terms of no longer than five years, with a cumulative maximum duration of ten years.*

- (b) If an independent member is appointed to more than one governing body within an AFM's group, the cumulative maximum duration of ten years referred to in (a) is calculated by adding the durations of each separate appointment and discounting periods during which appointments overlapped to avoid double counting.
- (c) In relation to a person who served as an independent director of an AFM's governing body before 1 October 2019, the five year term(s) and cumulative maximum duration of ten years run from that date.
- (5) Independent members are not eligible for reappointment to an AFM's governing body until five years have elapsed from the end of the ten year period referred to in (4).
- (6) The terms of employment on which independent members are appointed must be such as to secure their independence.

8.5.21      G      The guidance in COLL 6.6.26G applies to interpreting the requirement for independence in COLL 8.5.20R.

## TP 1      Transitional Provisions

### TP 1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
<u>48</u>	<u>COLL 4.5.7R(8) and (9) and COLL 8.3.5AR(5) and (6)</u>	<u>R</u>	<u>An authorised fund manager is not required to include the information prescribed by COLL 4.5.7R(8) and (9) or COLL 8.3.5AR(5) and (6) in its annual long report or in a composite report in respect of any annual accounting period ending before 30 September 2019.</u>	<u>From 30 September 2019</u>	<u>30 September 2019</u>

**COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK (MISCELLANEOUS AMENDMENTS) (No 2) INSTRUMENT 2018**

**Powers exercised**

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in or under:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
    - (a) section 137A (The FCA’s general rules);
    - (b) section 137T (General supplementary powers);
    - (c) section 139A (Power of the FCA to give guidance);
    - (d) section 247 (Trust scheme rules);
    - (e) section 248 (Scheme particulars rules);
    - (f) section 261I (Contractual scheme rules);
    - (g) section 261J (Contractual scheme particulars rules); and
  - (2) regulation 6(1) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force on 30 September 2019 immediately after the changes in Part 2 of the Collective Investment Schemes Sourcebook (Miscellaneous Amendments) Instrument 2018 (FCA 2018/17) come into force.

**Amendments to the Handbook**

- D. The Collective Investment Schemes sourcebook (COLL) is amended in accordance with the Annex to this instrument.

**Citation**

- E. This instrument may be cited as the Collective Investment Schemes Sourcebook (Miscellaneous Amendments) (No 2) Instrument 2018.

By order of the Board  
22 March 2018

## Annex

### Amendments to the Collective Investment Schemes sourcebook (COLL)

In this Annex, underlining indicates new text and striking through indicates deleted text

## 6 Operating duties and responsibilities

...

### 6.6 Powers and duties of the scheme, the authorised fund manager, and the depositary

...

Table of application

6.6.2 R This table belongs to *COLL* 6.6.1R.

<i>Rule</i>	<i>ICVC</i>	<i>ACD</i>	<i>Any other directors of an ICVC</i>	<i>Depositary of an ICVC</i>	<i>Authorised fund manager of an AUT or ACS</i>	<i>Depositary of an AUT or ACS</i>
6.6.26G		x	x		x	
<u>6.6.27R</u>		<u>x</u>	<u>x</u>		<u>x</u>	
Notes:	...					
	(5)	<i>COLL</i> 6.6.20R to <i>COLL</i> <del>6.6.26G</del> <u>6.6.27R</u> have a special application as set out in <i>COLL</i> 6.6.19R.				

...

#### Allocation of responsibility for compliance to an approved person

- 6.6.27 R (1) An AFM must allocate responsibility for ensuring its compliance with *COLL* 6.6.20R, *COLL* 6.6.25R, and, as applicable, *COLL* 6.6A.2R or *COBS* 2.1.4R to an *approved person*.
- (2) Where the chair of the AFM's governing body is an *approved person*, the AFM must allocate the responsibility set out in (1) to that *person*.

...

## 8 Qualified investor schemes

...

## 8.5 Powers and responsibilities

...

Application of value for money assessment and independent director rules

- 8.5.16 R *COLL 8.5.17R to ~~COLL 8.5.21G~~ 8.5.22R* apply to an *authorised fund manager* (other than an *EEA AIFM*) of an *AUT*, *ACS* or *ICVC*.

...

Allocation of responsibility for compliance to an approved person

- 8.5.22 R (1) An AFM must allocate responsibility for ensuring its compliance with *COLL 8.5.17R*, *COLL 8.5.20R*, and *COBS 2.1.4R* to an approved person.
- (2) Where the chair of the AFM's governing body is an approved person, the AFM must allocate the responsibility set out in (1) to that person.





## Appendix 2

### Final non-Handbook Guidance

## Finalised guidance

# FG18/3: Changing clients to post-RDR unit classes

April 2018

### Introduction

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- 1.1 This guidance sets out what we expect from firms that are involved in the transfer of fund investors from pre-Retail Distribution Review (RDR) unit classes<sup>1</sup> to post-RDR unit classes. This guidance replaces the guidance in FG 14/4 on the same subject.
- 1.2 We are setting out our approach as a result of a number of queries from stakeholders and some evidence of uncertainty in the procedure to adopt when converting clients to the new unit classes.

### Background

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- 1.3 The implementation of the RDR rules on adviser charging<sup>2</sup> and related rules for platforms have resulted in new unit classes (widely referred to in the industry as 'clean' unit classes) in authorised collective investment schemes. These post-RDR 'clean' classes bear a lower annual management charge (AMC), excluding the portion of the charge that was formerly rebated to advisers, in line with the RDR ban on commission payments.

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<sup>1</sup> The term 'unit class' is used throughout this document. References to 'unit' within the FCA Handbook apply to both units in an AUT and an ACS and shares in an ICVC. This document shares that referencing, so references to 'unit class' also include 'share class' in respect of an ICVC.

<sup>2</sup> PS10/6: *Distribution of retail investments: Delivering the RDR - feedback to CP09/18 and final rules*: <http://www.fca.org.uk/static/documents/policy-statements/fsa-ps10-06.pdf> (March 2010)

- 1.4 In the case of platforms, Policy Statement 13/1<sup>3</sup> referred to the introduction of clean unit classes and announced the banning of payments to platforms from product providers. These particular rules came into force on 6 April 2014 for new business, with the rules for legacy payments coming into force on 6 April 2016. Changes to 'legacy' business require platforms to have access to clean unit classes or to be able to pass on any continuing payments they receive from providers<sup>4</sup> to clients in full in the form of small cash rebates or unit rebates (COBS 6.1E.10R and 6.1E.11G).
- 1.5 A rule and guidance, setting out how the rules made in April 2013 apply to legacy business in relation to cash rebates to clients, were made on 27 February 2014 and came into force on 6 April 2014 (the same date as the rules made in April 2013).<sup>5</sup>
- 1.6 We have found that there is some uncertainty over whether a conversion to a clean unit class should be treated in the same way as a switch involving cancelling the existing units and issuing new units. Questions have also arisen about
- whether conversions can happen in bulk rather than individually
  - if conversions can happen without the express consent of the client
  - whether advice is needed
  - the role of advisers in the conversion process, and
  - whether a new disclosure document (e.g. a Key Investor Information Document (KIID) for a UCITS scheme) needs to be issued to the client before conversion.
- 1.7 This guidance answers these questions.

### **'Converting' unit classes**

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- 1.8 Various mechanisms exist to facilitate the move from one unit class to another. It is our understanding that in most cases, the move to clean unit classes will be accomplished by converting units (replacing one unit with another of a different unit class). The holder of the units has a right to request conversion from one class to another, as established in COLL 6.4.8R. The AFM may have a right to require the unitholder to convert to another class if certain conditions are met, as explained below.
- 1.9 We would expect the AFM, when undertaking a unit conversion, to have regard to the relevant tax regulations. Under those regulations<sup>6</sup>, an exchange of units in a single

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<sup>3</sup> PS13/1: Payments to platform service providers and cash rebates from providers to consumers: <http://www.fca.org.uk/static/documents/policy-statements/ps13-1.pdf> (April 2013)

<sup>4</sup> Reference to payments from providers to platforms in this guidance do not include payments by providers to advisers in the form of trail commission or facilitated adviser charges, as the platform simply acts as a conduit for these payments to advisers. The payments banned from 6 April 2014 were those payments previously paid by the provider and retained by the platform.

<sup>5</sup> Instrument 2014/16 - Feedback on the replies to the consultation in CP13/9 is contained in Handbook Notice 9: <https://www.fca.org.uk/publication/handbook/fca-handbook-notice-09.pdf>

transaction might have capital gains tax implications, but this will not usually be the case where the client receives only new clean units of the same fund with the same rights as before but a different AMC.

### **Conversion procedures for nominee arrangements**

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- 1.10 We would expect any AFM or other firm (e.g. platforms or discretionary investment managers) undertaking or facilitating the conversion of units to clean unit classes (and any firms providing advice to clients regarding conversions) to consider a number of points before proceeding, as set out below.

### ***Client's best interests rule and Principles for Businesses***

- 1.11 COBS 2.1.1R (1) (the 'client's best interests rule') in the FCA Handbook states:
- 'A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule).'
- 1.12 It is our view that under this provision and Principle 6 of the Principles for Businesses, a conversion initiated by the AFM, platform or other intermediary acting on behalf of a client should normally take place only if it is fair and in the client's best interests.
- 1.13 This would normally be the case where the clean unit class is exactly the same as the pre-RDR class, except for a reduced AMC. However, it is possible that this may not be the case if the reduced AMC, combined with any new platform charge (or other charges), will lead to an overall increase for clients. It is also possible, depending on the charging structure, that some clients may be better off and others worse off.
- 1.14 For retail clients, 'clear' disclosure of the platform charge is required in any event by COBS 6.1E.1R, which came into force on 6 April 2014.

### ***Prior notification of a proposed conversion and treatment of investments where the client objects to conversion***

- 1.15 To mitigate the risk that some clients may be worse off, firms should ensure in all cases that clients have sufficient notification of, and information on, the proposed conversion to enable them to seek advice or make an informed decision on whether to transfer their investments to another platform.<sup>7</sup> The notification should include information on whether there is likely to be an overall increase in charges for clients, as a result of the reduced AMC combined with the new platform charge (or other charges).

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<sup>6</sup> The Collective Investment Schemes (Tax Transparent Funds, Exchanges, Mergers and Schemes of Reconstruction) Regulations 2013, SI 2013/1400

<sup>7</sup> Under COBS 6.1G.1R, such transfers must take place when requested by the client 'within a reasonable time and in an efficient manner'.

- 1.16 If a client objects to the conversion, their investments can continue to be held in the bundled class if the AFM is willing to continue to offer this option. However, payments from providers that (prior to 6 April 2016) were retained by the platform now have to be passed to the client in full, in the form of small cash rebates or unit rebates. If a nominee does not intend to offer clients the option of remaining in pre-RDR classes and receiving unit rebates, it should be made clear to the client that this is not an option open to them.

### ***Approach to be adopted by nominees***

- 1.17 A 'unitholder' is defined in our Handbook<sup>8</sup> as 'the person whose name is entered on the register (of unitholders)'. When the underlying investor uses an intermediary such as a platform, that firm's nominee is the registered holder of the units, so the COLL rules permit the nominee to exercise any right to convert from one class to another.
- 1.18 We expect nominees to ensure the client is given prior notification that the conversion will take place and is given sufficient time to consider other options. For example, the notification could state that the conversion will take place unless the client objects within a reasonable specified timeframe (where retaining the current class is offered as an option) or notifies the firm that they wish to sell their investments or transfer to another platform. Such a notification should be made in a manner appropriate to the nominee's ongoing dealings with the client. For example, if a nominee deals with the client primarily by electronic communication, such as email, the notification should be made by this method.
- 1.19 Nominees should bear in mind any notification, disclosure or other contractual requirements that may exist in their contractual relationship with the client or the client's chosen financial adviser, concerning the nominee arrangements. This guidance contains our position on conversions, but firms should also bear in mind that the conversion will also be subject to any contractual arrangements firms have agreed with the underlying investor.

### **Conversion procedures for direct unitholders**

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- 1.20 The COLL rules envisage authorised fund managers undertaking a mandatory conversion of units if
- the circumstances in which mandatory conversions will take place are set out in the prospectus of the fund<sup>9</sup>, and
  - the client's best interests rule is satisfied.<sup>10</sup>
- 1.21 If the prospectus does not refer to mandatory conversion, the AFM can amend it to allow such conversions of units. The AFM would need to consider how this change to the

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<sup>8</sup> <https://www.handbook.fca.org.uk/handbook/glossary/?starts-with=U> .

<sup>9</sup> COLL 4.2.5R 5(d)

<sup>10</sup> COBS 2.1.1R (1) and PRIN 6

prospectus would be treated under COLL 4.3 (Approvals and notifications) to ensure unitholders were properly informed about possible mandatory conversions in future.

- 1.22 To satisfy the second condition, we expect AFMs to send the relevant unitholders a notification of the planned mandatory conversion, with a notice period of reasonable length (not less than 60 days), to enable them to redeem their units if they do not wish to be converted and to alert them to alternative options, if available.
- 1.23 The AFM can proceed with the conversion if:
- by the end of the notice period, it has not received alternative instructions about the units affected by the proposed conversion, and
  - the AFM is satisfied on reasonable grounds, having considered, in particular, the costs to unitholders associated with the old and new classes of units, that the conversion will not result in detriment to the unitholders concerned.
- 1.24 An AFM should not make other changes to investors' rights as part of a mandatory conversion to a cheaper but otherwise identical class.

### Advice on conversions

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- 1.25 Some questions have focused on whether a conversion would constitute advice. For nominees, issuing a notification that a clean unit class exists to which it is proposed to convert all existing clients' holdings, explaining (where this is the case) why it is in the client's best interests, does not constitute advice.
- 1.26 For the AFM, notification to direct unitholders that a clean unit class exists (without a specific recommendation to convert to that class) does not constitute advice. Similarly, prior notice of a mandatory conversion is not advice. If the client is given such a notification, they then have the option to seek advice on the matter.

### Advisers and their role in the conversion process

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- 1.27 If the client is investing in a fund as a result of the recommendation of a financial adviser and that relationship still exists, then that adviser may have a role to play in the conversion process.
- 1.28 Legacy payments to platform providers came to an end in April 2016 (unless passed on in full to clients in the form of small cash rebates or unit rebates).
- 1.29 Additionally, we would encourage platforms and product providers to engage with a client's financial adviser in good time when considering converting holdings to clean unit classes, so the financial adviser has an opportunity to discuss the conversion with their client as appropriate.

## Providing a new disclosure document when converting to clean unit classes

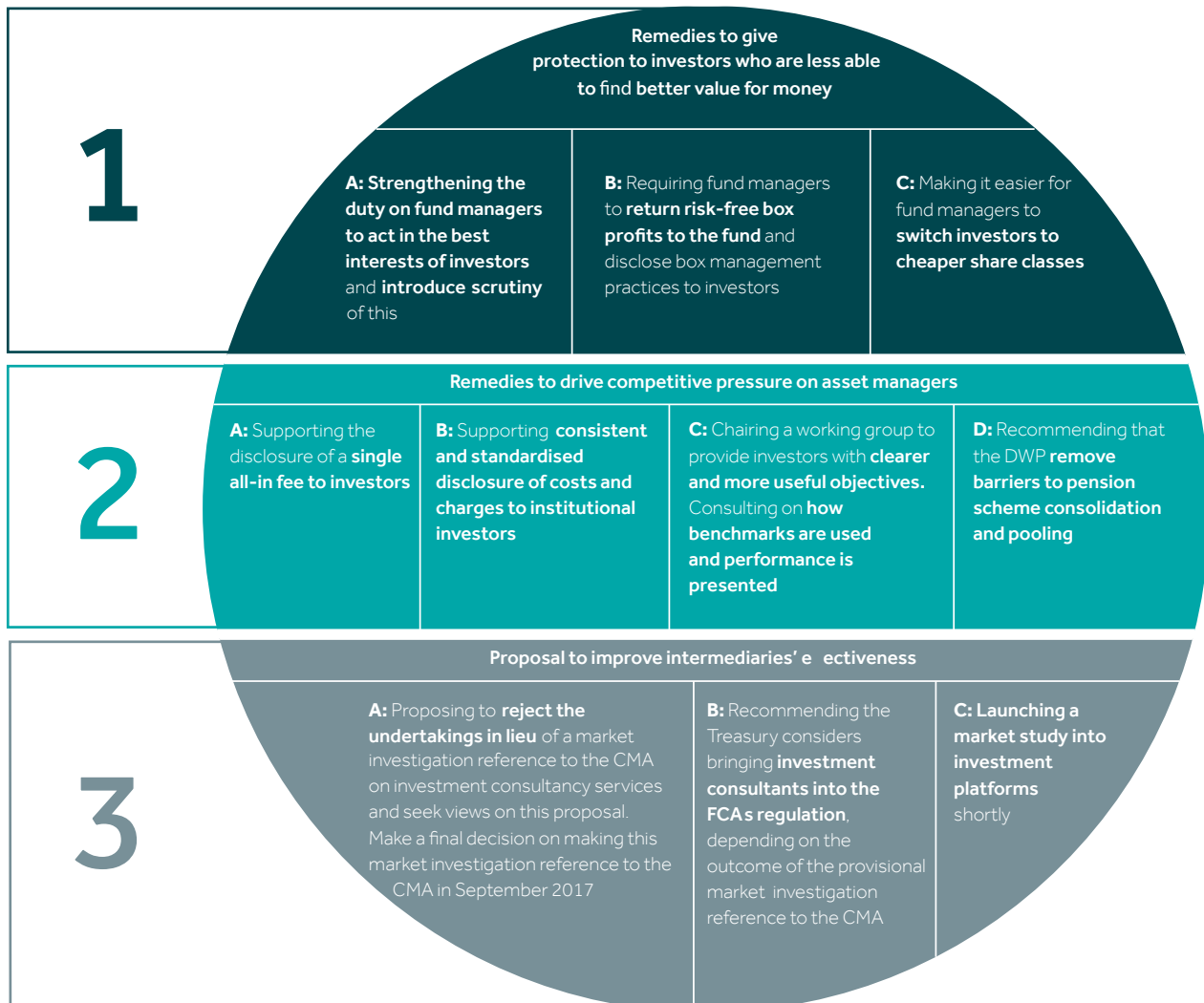
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- 1.30 There have been some questions about whether a conversion from a pre-RDR unit class to a clean unit class requires a new disclosure document, such as the KIID, to be provided to the client for the new unit class under COBS 14.2.1R(7).
- 1.31 Where the move to clean unit classes will be accomplished by conversions, we consider that a new disclosure document, such as a KIID, would not need to be provided as long as
- the firm has taken reasonable steps to assess whether the conversion is in line with the client's best interests rule and Principle 6 of the Principles for Businesses (treating customers fairly)
  - in all cases where the conversion is initiated by the AFM, platform or other nominee, the client has been given sufficient notification of, and information on, the proposed conversion to enable them to seek advice or make an informed decision on whether to transfer their investments to another platform
  - the notification includes information about whether there is likely to be an overall increase in charges for clients, as a result of the reduced AMC combined with the new platform charge (or other charges), and
  - clients are given the option to request the KIID for the clean unit class, or advised how they can access the document electronically.

## Appendix 3

### An overview of all AMMS remedies

#### 1. AMMS remedies in Final Report





## 2. Update to AMMS remedies

### 1: Remedies to give protection to investors who are less able to find better value for money

A, B & C

Final rules and guidance for these remedies are set out in this PS.

### 2: Remedies to drive competitive pressure on asset managers

A

Single charge: PRIIPs and MiFID II now apply and firms subject to those requirements must produce information broadly equivalent to a single charge when communicating to investors about costs and charges.

We have also conducted research on certain complementary areas which we are publishing alongside this PS, in OP32.

B

The Institutional Disclosure Working Group of industry and investor representatives was launched in September with a view to agreeing a template for the disclosure of costs and charges. The Group is expected to make recommendations on this to the FCA before the Summer of 2018.

C

A CP published alongside this PS covers these matters.

D

At the time of publication of the AMMS final report we recommended that the DWP continue to review and where possible remove barriers to pension scheme consolidation and pooling.

### 3: Proposal to improve intermediaries' effectiveness

A

We reached a final decision to make an MIR on investment consultancy and fiduciary management services and to reject the UIL; the CMA launched a market investigation into investment consultants on the 14 September 2017 and will conclude the investigation by March 2019.

B

We have recommended that the Treasury consider an extension of our regulatory perimeter to include asset allocation advice subject to the findings of the market investigation reference to the CMA.

C

The Investment Platforms Market Study terms of reference was published in July 2017 and we aim to publish an interim report by summer 2018.

