Asset Management Market Study – Final Rules

A reminder that the **second** tranche of rules arising from Policy Statement **PS18/8** – "Asset Management Market Study remedies and changes to the handbook – Feedback and final rules to CP17/18" will apply from **30 September 2019**.

The final rules are addressed to UK authorised fund managers ('**AFM**') in respect of their authorised funds. Whilst that term may bring to mind e.g. a UCITS, the Handbook definition captures an:

- investment company with variable capital ("ICVC"); or
- authorised unit trust ("AUT"); or
- authorised contractual scheme ("ACS").

For the avoidance of doubt an **AIFM** can also be categorised as an AFM e.g. where the scheme is a NURS. The changes will, of course, also be of interest to **MiFID** investment firms that are the **delegated portfolio managers** of such funds.

Independent directors (COLL 6.6.25 – 6.6.26)

- At least **one quarter** of an AFM's governing body must comprise of '**independent natural persons' directors**, with a **minimum of two** such independent directors (natural persons) where the governing body consists of less than eight members.
- Independent members of the AFM governing body must be appointed for terms of no longer than **five years**, and a maximum cumulative duration of **ten years** (the ten years is cumulative where such a member is appointed to more than one governing body within a group). **No reappointment** will be permitted until **five years** have elapsed after having served on the governing body for the maximum duration of ten years. Where independent persons are already sitting on the governing body before 1 October 2019 then the five and ten year periods run from that date.
- **Guidance** is provided on the FCA's view of '**independent**' for these purposes, the **role** of such members and their **contractual terms**. The guidance also advises that any **vacancies** arising in the number of required independent directors should be filled as soon as possible and, in any event, within **six months**.

Assessment of value (COLL 6.6.20 – 6.6.24 & COLL 4.5.7(8) & (9))

- An AFM must carry out an assessment, **at least annually**, of whether **each** scheme it manages provides **value for money** for investors in terms of payments made out of the scheme (COLL 6.6.21 sets out the **minimum considerations** when making the assessment – separately for **each class** of units in a scheme where relevant).
- The **annual long report** (COLL 4.5.7) of the fund must include **details** of this annual assessment, including a separate discussion and conclusion for each element that was included in the assessment. However where an AFM makes an annual statement on the assessment of value available to investors in a composite report covering two or more authorised funds then this information need not be duplicated in the annual long report.
- Transitional provision TP1(48) means that an AFM does **not** have to include this information in either a composite statement or the annual long report in respect of any annual accounting period **ending before 30 September 2019**.
- The FCA cautions AFMs that failure to take sufficient steps to address any instance where a fund's charges are not justified in the context of an assessment will be regarded as tending to establish that the firm is not acting in the best interests of the investors.

The minimum considerations for the assessment include 'classes of units' and concerns the need to consider whether it is appropriate for investors to have holdings in classes that are subject to higher charges than other classes of the same scheme with substantially similar rights. Although COLL 6.6 provides no further commentary, it is noted from CP17/18 that two specific examples quoted where investors "would be demonstrably better off in a cheaper class" were:

- investors that are in pre-RDR classes that no longer pay trail commission
- investors in pre-RDR classes that continue to pay trail commission

Allocation of responsibility (COLL 6.6.27)

- Responsibility for compliance with the above two matters must be allocated to an approved person.
- Responsibility for compliance with the requirement to act in the best interests of the fund and its investors as per COLL 6.6A.2 (AFMs of UCITS schemes to act in the best interests of the fund and its investors) and COBS 2.1.4 (AIFMs' best interest rules), as applicable, must be allocated to the same person.
- Where the **chair** of the AFM's governing body is an approved person, then responsibility must be allocated to that person.

We would remind AFMs that under the forthcoming **Senior Managers and Certification Regime** (9 December 2019) there will be the 'Prescribed Responsibility' (which will need to be held by a Senior Manager) of:

"Responsibility for an AFM's value for money assessments, independent director representation and acting in investors' best interests".

The new rules can be found in Appendix 1 of PS18/8 or by using the 'timeline' facility within the on-line Handbook.

For the record, the **first** tranche of rules arising out of PS18/8 applied from 1 April 2019 and concern when an AFM deals as principal as summarised below.

Box profits (COLL 6.3.5D & E and COLL 4.2.5(17)(j))

- The treatment of box profits will depend upon whether they are deemed 'risk-free' or 'at-risk'.
- If, at the **same valuation point**, the AFM is able to execute a sale instruction by selling units it has just redeemed to the investor without putting its own capital at risk, the **profit** so arising **cannot be retained** by the AFM or its associates. Instead, any such profit must either be paid back to the fund **or** redistributed among the transacting investors.
- On the other hand, it will still be permitted for an AFM to retain any profits made in **carrying over** units to a **later valuation point** i.e. the AFM is putting its own capital at risk. However, the AFM will **not** be allowed to profit in situations where it is not exposed to an equal risk of loss i.e. should the units fall in value over the valuation points **or** where there is the ability to match simultaneous sales and redemptions at different prices at no risk to its capital.
- Where a box is operated the prospectus must include its policy for doing so and describe when the AFM may retain any profits earned.

Note that whilst COLL 6 is associated with UCITS/NURS, similar requirements also apply to **qualified investor schemes** – see **COLL 8.3** and **COLL 8.5**.

Useful Links

PS18/8

FCA Guidance: Changing clients to post-RDR unit classes

CP17/18