INVESTMENT COMPANY INSTITUTE

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FCA Publishes a Dear CEO Letter Outlining Its Asset Management Supervision Strategy

[32173]

January 27, 2020 TO: International Compliance Advisory Committee
International Internal Audit Advisory Committee RE: FCA Publishes a Dear CEO Letter Outlining Its Asset Management Supervision Strategy

Last week the Financial Conduct Authority (FCA) published its latest "Dear CEO" letter.[1] The letter outlines the FCA's view of the seven key risk of harm that asset managers pose to their customers or the markets and the FCA's supervision strategy in response to these risks. It recommends that, for those firms that present the risks identified, they consider their mitigation strategy. The letter prefaces its discussion of the FCA's supervisory priorities, which are discussed in more detail below, with the following:

> Overall standards of governance, particularly at the level of the regulated entity, generally fall below our expectations. Funds offered to retail investors in the UK do no consistently deliver good value, frequently due to failure to identify and manage conflicts of interest. Inadequate investment in technology and operations resilience has led to deficient systems which could cause harm to market integrity or loss of sensitive data.

According to the letter, the FCA expects asset managers to consider the FCA's supervisory priorities and take appropriate action. The letter discusses the following seven supervisory priorities.

Liquidity Management

In its discussion of liquidity management, the letter notes the FCA's 30 September 2019 policy statement on illiquid assets and open-ended funds[2] and its 4 November letter to boards of authorized fund managers (AFMs)[3] outlining its expectations regarding liquidity management. It notes that the FCA expects AFMs "to take any necessary or appropriate action following these communications." Where the FCA identifies potential liquidity issues in funds, it "will ensure that AFMs take prompt action to mitigate or resolve them."

Firms' Governance

The letter notes that the FCA's Senior Managers & Certification Regime (SMCR) was extended to the asset management sector on 9 December 2019. As a result, the FCA expects AFMs "to have refreshed your approach to governance and taken the necessary steps to improve it in lines with SMCR requirements." During the first half of 2020, the FCA will carry out work to evaluate the effectiveness of governance across the sector with a focus on firms' efforts to implement SMCR. The FCA expects firms "to recognize and take steps to mitigate harm arising from any conflicts of interest between affiliates, most notably between the AFM entity and any delegate investment management entity."

Asset Management Market Study (AMMS) Remedies

The letter notes that the FCA's AMMS Final Report was published in June 2017[4] and, thereafter, the FCA introduced a series of rule changes to address concerns identified in the report. During the first half of 2020, the FCA expects to do work to both understand how effectively firms have undertaken value assessments and evaluate the effectiveness of the AMMS reforms by, in part, seeking "evidence of meaningful challenge at AFM boards on proposals made by the executive – including on costs, fees and product design." As it assesses and authorizes investment funds, the FCA expects firms "to ensure that funds' objectives are clear, fair, not misleading and that they comply with the new rules around objectives disclosure . . .." It plans to "publish certain key metrics, such as on long-term underperforming active funds and trends within the sector to provide evidence of whether the reforms are having their desired effect." The FCA also plans to "continue to take robust action where [it identifies] funds which deliver poor value, including so-called 'closet trackers.'"

Product Governance

The letter mentions the MiFID II requirements from 2018 that were intended to "ensure customer interests remain central throughout the product lifecycle." It expresses the FCA's interest in seeing products that are designed "with the best interests of a specified target market in mind." According to the letter, "[s]uch products should not include features that are manifestly not in the interests of customers, which could include funds tracking an undisclosed index or where fees exceed target returns." It notes that the FCA has "begun a review to assess how effectively new product governance provisions have been implemented across the sector." It expects to complete this work in early 2020. As part of its governance the review, the FCA will also be focused on funds that are managed by AFMs that are not within the group structure of the delegate investment manager, which are "often know as 'host' ACDs – Authorised Corporate Directors." The FCA is "concerned that 'host' ACDs may not be undertaking their responsibilities effectively in some cases, leading to poor value products and them failing to ensure risks are properly managed." In tandem with its product governance review, during early 2020 the FCA will be reviewing how effectively 'host' ACDs undertake and properly discharge their responsibilities, including their day-to-day management of the fund.

LIBOR Transition

The FCA's letter notes the FCA's September 2018 Dear CEO letter on LIBOR[5] and the FCA's expectation that firms should recognize their responsibilities to facilitate and contribute to an effective transition to new, more appropriate rates, such as SONIA. The FCA expects to provide further communications on its specific expectations for LIBOR transition in due course.

Operational Resilience

The FCA expects firms to manage their technology and cyber risk appropriately, including through appropriate oversight of third party firms and intra-group service providers. It notes that its Consultation Paper on Operational Resilience[6] outlines a proposed approach to strengthen the operational resilience of financial services firms. Asset managers that have a great risk of causing harm are now subject to proactive technology reviews by the FCA. It plans to be in touch with those firms that it has selected to participate in these reviews. The FCA has published a review of technology resilience in the asset management sector[7] and it reminds firms that, if they suffer a material technological failure or cyber attacks, the FCA expects the firm to contact it "promptly as part of your responsibilities under Principle 11."[8] The FCA expects to undertake further proactive work on operational resilience in the coming months.

EU Withdrawal

The final priority discussed in the FCA's letter is the UK's withdrawal from the EU with an implementation period operating until 31 December 2020. The FCA expects firms "to consider how the end of the implementation period will affect you and your customers, and what action you may need to take to be ready for 1 January 2021." The FCA's website includes information on Brexit.[9] The FCA expects to update this information after the UK's exit from the EU.

Persons with queries about the FCA's letter should contact the FCA's dedicated Supervision Hub. For urgent issues of strategic importance, firms should instead contact the Head of the Asset Management Department. The letter includes the contact information for the Hub and the Department.

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endnotes

[1] The letter is available on the FCA's website at: https://www.fca.org.uk/publication/correspondence/asset-management-portfolio-letter.pdf.

[2] *See* https://www.fca.org.uk/publication/policy/ps19-24.pdf.

[3] *See* https://www.fca.org.uk/publication/correspondence/letter-effective-liquidity-management-good-practice-authorised-fund-managers.pdf.

[4] *See* https://www.fca.org.uk/news/press-releases/fca-publishes-final-report-asset-management-sector, which summarizes the Final Report and includes a link to it.

[5] *See* https://www.fca.org.uk/news/statements/dear-ceo-libor-letter.

[6] *See* https://www.fca.org.uk/publication/consultation/cp19-32.pdf.

[7] *See*

https://www.fca.org.uk/publications/multi-firm-reviews/wholesale-banks-asset-management-cyber-multi-firm-review-findings.

[8] *See* https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html.

[9] *See* https://www.fca.org.uk/brexit.
