5 July 2018

Karen Northey
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By email to: cp18-09@fca.org.uk

Dear Karen,

**CP18/9: Consultation on further remedies – Asset Management Market Study**

The Depositary and Trustee Association ("DATA") represents depositaries and trustees of UK based investment funds, including Open Ended Investment Companies, Unit Trusts and Authorised Contractual Schemes.

DATA's responses to the questions raised in the consultation are in the attached annex. Please do not hesitate to contact me if you would like to discuss any of the points we have raised.

Yours sincerely

Darren Lewis
DATA Chairman

## Annex

### DATA Response to FCA CP18/9 – Consultation on further remedies – Asset Management Market Study

### Executive Summary

DATA agrees with the policy intention of proposals in the consultation. It is important that investors understand what the fund they are investing in is aiming to achieve, how it will be managed, they can easily determine how the fund has performed against its stated objective and performance fees fairly reflect the net performance delivered for investors.

We do however believe there are some points in the detail of the proposals that should be considered, including:

- FCA publishing examples of good and poor practice on objective descriptions.
- Amending COLL 5.2.4R (for UCITS) and COLL 5.6.4R (4) (for NURS) to refer to schemes placing further investment restrictions in the prospectus or instrument.
- Ensuring the definition of "constraint" only captures those funds whose investment portfolios are constrained by benchmarks.
- Placing the prospectus requirements for benchmark disclosure in their own section, not under the prospectus requirements for investment and borrowing powers.
- Placing the new rule requiring a performance fee to be calculated against net performance ahead of guidance on performance fees.
- Ensuring the detailed requirements are proportionate in relation to the cost impacts of the proposals on depositaries and investors, in particular the impact of licencing costs.
- Provide for a more realistic implementation timetable to coincide with the annual review of fund documentation.

Finally, DATA believes it would be helpful if the FCA could publish and broadly communicate its expectations on fund authorisations and fund changes to the wider industry on a regular basis. There would be greater effectiveness, in DATA's opinion, if the FCA formally shared its views publicly.

### Q1: Do you agree with our draft guidance on fund objectives?

We have no comments on the draft guidance on fund objectives.

We note that some members of the Fund Objectives Working Group asked the FCA to publish examples of what the FCA did not like (Paragraph 3.23). We understand that the FCA has decided not to include specific examples in the draft guidance but has included generic examples of poor practice in the Consultation Paper.

We would encourage the FCA to publish examples of good and poor practice as it does help the industry and can lead to the development of consistency in approach which, in turn, can be useful to investors.

We also enquire as to why the guidance is being issued as non-handbook guidance rather than being reflected as guidance within the relevant sections of the handbook. Alternatively, it could be signposted in the relevant sections of the handbook so that firms are alert to the fact that important information is set out elsewhere.

We also note that for the fund objectives proposals to work, amendments will be required to COLL 5.2.4R (for UCITS) and COLL 5.6.4R (4) (for NURS). While these refer to the instrument constituting the scheme being able to place further restrictions on the investment powers and spread limits, there is no restriction to these being placed in the prospectus. This contrasts with the equivalent provision for QIS in COLL 8.4.3R (2), which refers to both the instrument and the prospectus. In practice, further restrictions on investment powers are rarely placed in the instrument, instead these will typically be

included in the prospectus. COLL 5.2.4R and COLL 5.6.4R (4) should therefore be amended to reflect this.

The six month transition period proposed is likely to be too short for most AFMs to complete a meaningful revision of objective and strategy description, depending on the number and complexity of funds they manage. The depositary will not be involved in, or oversee, any review of the objective, policy and strategy description in the key investor information document or fund factsheets. However, if in the course of reviews AFMs determine that changes to objective and investment policy descriptions also need to be made to the prospectus, the latter will need to be reviewed by the depositary. Changes to objective and investment policy descriptions typically require a more detailed review by the depositary, to ensure these are clear, permissible under the regulations and can be monitored against, and that the AFM's proposed treatment of the change under COLL 4.3 is reasonable. This review therefore requires more time on the part of depositaries, who may receive a number of these requests at the same time due to the changing requirements. We suggest that the implementation should coincide with the annual review of fund documentation to minimise additional production and dissemination costs.

**Q2: Do you agree that we should introduce a 'requirement to explain' with regard to AFMs' use of benchmarks?**

DATA believes it is reasonable that AFMs should explain the use of benchmarks in the management of the portfolio. We broadly agree that the three categories of benchmark use defined by the FCA seem logical, although outlined below are some points for consideration and suggested amendments in relation to the detail of proposals.

We support the principle that a fund whose portfolio construction is genuinely constrained by a benchmark should properly disclose this to investors in the prospectus and investor facing documents. However, we do have concerns that the definition of "constraint" may be too broadly drafted, and could therefore capture a far broader range of funds for which the investment objectives and policy are not constrained by a benchmark, but where benchmarks are used for risk monitoring purposes or as a reference for calculating performance based remuneration of the portfolio manager. Capturing such funds could cause problems in the compliance monitoring of depositaries, for example if a benchmark is listed as a constraint due to it being used for risk management purposes, and a portfolio moves significantly away from the benchmark, would the depositary be expected to challenge this even though the portfolio had not deviated from the investment policy?

In addition, we are concerned that in seeking to avoid their funds being seen as constrained, some AFMs may remove benchmarks from their risk management processes, which in some cases could lead to less robust risk management processes to the detriment of investors. This could make it more difficult for depositaries to be able to objectively assess AFMs' systems and controls as part of their compliance monitoring programs. DATA therefore encourages the FCA to consider responses from AFMs and their representative bodies in respect of the definition of constraint, to ensure it only captures those funds whose portfolios are genuinely constrained by a benchmark.

We question the inclusion of the three new categories of benchmark, and the rules on disclosure in the prospectus of benchmarks, in the prospectus requirements for investment and borrowing powers in COLL 4.2.5R(3). These new definitions of benchmark do not all apply to investment restrictions, in particular comparator benchmarks, therefore it is not wholly appropriate for them to be included in the investment and borrowing powers section of the prospectus requirements. We believe the same aims can be met without the confusion of placing all benchmark references in the investment and borrowing powers section by creating a new requirement under a new COLL 4.2.5R(3A) – with some minor amendments to the proposed text this would be clearer.

The cost benefit analysis (CBA) provided in Annex 2 does not consider the cost impact, both one-off and ongoing, on depositaries. The benchmark requirements, if the current definitions of the three categories are used, will require a significant number of funds, possibly a majority, to make changes to their prospectuses. All of these changes will require applications which will need to be reviewed by depositaries. In addition, where it is determined that a benchmark is a constraining benchmark (that has not previously been disclosed), the depositary will have to adapt its investment monitoring to ensure the manager is investing scheme property in line with the constraints. This could result in the depositaries needing to source benchmark information from benchmark providers in order to compare against the portfolio, which is likely to incur additional licencing costs for depositaries.

Similar to our response in Q2, we do not believe the proposed implementation time of 6 months will be long enough, and given the volume of changes to prospectuses likely to be required such a time frame will put pressure on depositaries, who will need to review and sign all fund change applications. The implementation timetable should coincide with the annual review of fund documentation to minimise additional costs and spread out the implementation.

**Q3: Do you agree that we should introduce rules and guidance to require consistency in references to benchmarks across the same fund's documentation?**

We agree that there should be consistency in references to benchmarks across the same fund's documentation, and therefore support the policy intention of this proposal.

**Q4: Do you agree that we should introduce rules and guidance on which benchmarks should be displayed against a fund's past performance, where past performance is shown?**

We support the intention of the proposal, however we do have some concerns about the practicality and ultimately the usefulness to investors of these proposals.

Where a fund uses multiple benchmarks, we question whether it will be helpful to show performance against all benchmarks. Our concern is that this could confuse investors rather than help them in understanding how their fund has performed against its investment objective. We recommend that in fund documentation, including the prospectus, AFMs are instead required to show performance against the most appropriate benchmark, with an explanation provided for why that benchmark is selected.

We also note that AFMs may find it difficult to explain where no benchmark is being used, how investors can assess the performance of their fund against its objective without using a benchmark, or inadvertently creating a benchmark.

The FCA should be mindful that in addressing disclosure of performance against benchmarks, it does result in undue prominence being given by investors to past performance. Past performance is not a reliable indicator of future performance, and historic outperformance against a benchmark does not mean that the fund manager or investment strategy will continue to outperform in future, and on its own will not give a complete picture of the risks taken to achieve the performance.

Finally, related to a similar point in our response to Q2, the CBA does not consider the impact of licencing costs for use of benchmark indices. Many prospectuses permit these costs to be borne by the fund, therefore there is likely to be a cost impact on investors arising from these proposals. This should not be used as a reason for hiding benchmarks where they are used as targets or constraints in the investment process. However, the impact of licencing costs on investors should be considered by the FCA in determining whether particular requirements in relation to benchmark disclosures are proportionate.

**Q5: Do you agree that we should remove the possibility that performance fees could be taken on gross performance?**

DATA agrees with this proposal, noting that this has been best practice among AFMs using performance fees for some time.

We do, however, suggest that as a matter of form rules should precede any related guidance provisions in the Handbook. We would therefore suggest that the proposed rule in COLL 6.7.6AR should precede the guidance in COLL 6.7.6G, eg as a new rule COLL 6.7.5AR.