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MEMBER GUIDANCE

ACD Governance

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Introduction

An Authorised Corporate Director¹ (ACD)'s ultimate responsibility is to the funds it manages and therefore to the investors in those funds. The ACD must act honestly, fairly, professionally and independently². When acting as UCITS management company, the ACD must also act solely in the interests of the fund and its investors³ or, when acting as AIFM, in the best interests of the funds and its investors and the integrity of the market⁴.

The purpose of this Guidance is to remind all ACDs of their duties to act in investors' best interests and the FCA's expectations of them. The guidance particularly draws on learnings from the FCA's multi-firm review on independent ACDs, amongst other reviews. The term ACD is used throughout, to refer to ACDs and AFMs. We will also be considering how the guidance will need to evolve as the new Consumer Duty is implemented.

The ACD normally assumes one of three models:

1. The "internal ACD" model, where the ACD of the fund is part of the same corporate group as the firm performing investment management (or is itself the entity performing investment management). The FCA's expectation is that the activities must be formally separated between the ACD and any delegated investment management company. Internal ACDs may also outsource investment management for certain types of fund, or a particular aspect of the fund, e.g. managing a hedging overlay.
2. The "independent (or host) ACD" model. With this model, an independent ACD will be appointed from outside the corporate group to which the investment manager belongs.
3. Those ACDs who are also the sponsors or promoters of the fund, but outsource the investment management. This model is relatively uncommon, but has been adopted by some distribution-focused firms..

The guidance in the Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD⁵) sets out the FCA's view on what various rules require of providers and distributors in certain circumstances to ensure they treat investors fairly and act in their best interests. The guidance also identifies some examples of what the FCA thinks acting in the best interests of investors means in practice for ACDs. The FCA has also recently published the rules for a new Consumer Duty, which were finalised on 27 July 2022⁶ and which will apply to ACDs.

What an ACD has to do to meet the regulatory requirements of a Principle will depend on its circumstances, including the risk profile and/or complexity of the funds it manages, who the firm is dealing with (an intermediary firm or an investor, for example) and the financial sophistication of the target market.

An ACD is permitted by the regulations to delegate some of the functions involved in operating a fund⁷, such as management of the fund's assets, promotion of the fund or fund administration, but it is not considered good practice to delegate both portfolio management and risk management outside of the ACD or its group. The ACD may not delegate its regulatory responsibility and therefore remains

¹ Authorised Corporate Director and ACD are used in this document as a shorthand for all forms of authorised fund manager.

² For UCITS, COLL 6.6A.2 R (6)(a) and COBS 2.1.1 R and for AIFs, COBS 2.1.4 R (1) and FUND 3.11.5 R

³ COLL 6.6A.2 R (6)(b)

⁴ COBS 2.1.4 R (2)

⁵ https://www.handbook.fca.org.uk/handbook/document/rppd/RPPD_Full_20190329.pdf

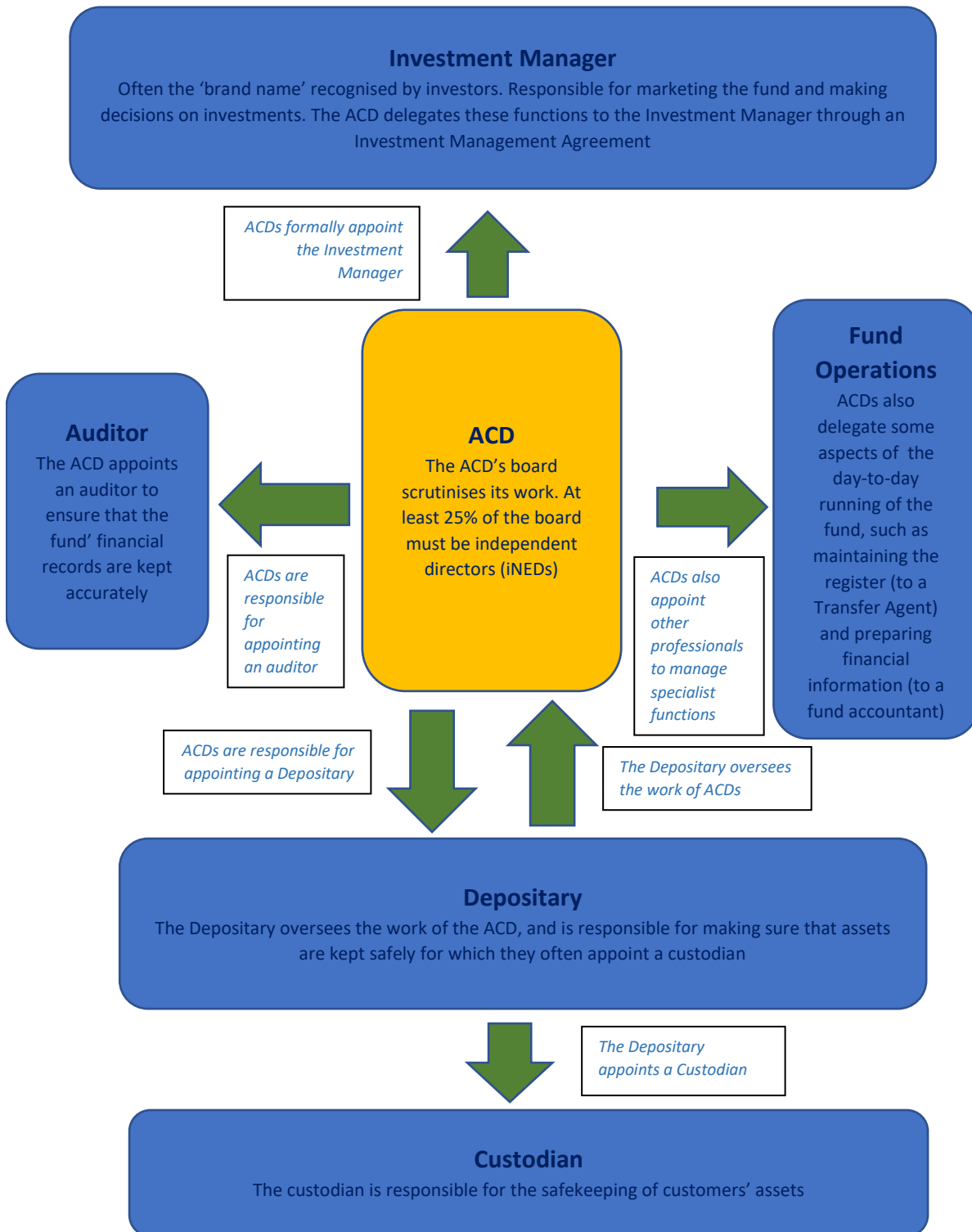
⁶ See [PS22/9](#) "A new Consumer Duty: Feedback to CP21/36 and final rules" and [FG22/5](#) "Finalised Guidance: Final non-Handbook Guidance for firms on the Consumer Duty"

⁷ COLL 6.1.3 G (2)(a)

responsible for the performance of those functions, no matter who physically performs them⁸.

There are a number of parties involved in the management of a fund, as illustrated below in Fig. 1. This illustrates how various activities in the management of a fund may be delegated.

Fig. 1: Fund Management and Parties Involved



⁸ COLL 6.6.16 G (1)

Various parties in the fund management chain have oversight responsibilities. The ACD's board scrutinises how funds are managed and Independent Non-Executive Directors (iNEDs) will have been appointed with sufficient expertise and experience to make judgements on whether the AFM is managing the fund in the best interests of investors, and challenge Executive Directors where required⁹. The Depositary, as part of its role, has a duty to oversee some of the ACD's activities¹⁰ and has a corresponding duty to act honestly, fairly, professionally and independently in the interests of the fund and its investors¹¹. ACDs will also have responsibility for and oversight of any third parties that they delegate management functions to, such as investment management, to ensure that those functions are being performed according to the regulations and in investors' best interests.

Where the ACD and investment manager are part of the same group and share the same ultimate governing body, or where the ACD carries out investment management itself, it needs to demonstrate the ability to perform independent oversight of the investment management function.

⁹ COLL 6.6.25 R (3)

¹⁰ COLL 6.1.3 G (3), COLL 6.6B.16R and FUND 3.11.25 R

¹¹ E.g. see FUND 3.11 R

1. Regulatory background

Over the past decade, the FCA has undertaken three multi-firm reviews¹² of the independent ACD sector, as well as the all-encompassing Asset Management Market Study¹³, which looked at the asset management sector in its entirety, with a particular emphasis on fund management. In July 2022, the Consumer Duty was finalised, which has wider application across the retail financial services industry.

Earlier FCA Reviews of independent ACDs

The FCA conducted multi-firm reviews of independent ACDs in 2012 and 2014 and in both cases found similar failings at independent ACDs, namely a lack of oversight and due diligence of delegated third-party investment managers, lack of resources, a lack of understanding of some of the strategies used by the delegated third-party investment managers and poorly-controlled inherent conflict of interests. Following these reviews, the FCA sent individual letters to the firms visited, but did not issue any wider industry communications.

Asset Management Market Study

These reviews were followed up with the Asset Management Market Study (AMMS) in 2015 – 2016. The Final Report of the AMMS proposed three sets of remedies to:

- (a) enhance consumer protection,
- (b) drive competitive pressure on asset managers and
- (c) improve the effectiveness of intermediaries.

The aim of all these remedies was to address the AMMS' key finding, namely that there is weak price competition in a number of areas of the asset management industry.

The enhanced consumer protection remedies included proposals for a new fund governance regime (the introduction of the value assessment and enhanced requirements for iNEDs), ways to facilitate share class switching, and passing on risk-free box profits from the ACD to investors and the funds it manages. In April 2018, the FCA re-issued final guidance¹⁴ on legacy share class conversions, allowing ACDs to process share class conversions without the investor's consent in specific circumstances and where in the best interests of investors. Under the competitive pressure heading, the FCA introduced an enhanced regime on the disclosure of fund objectives and the clearer use of benchmarks¹⁵.

MiFID II Product Governance Thematic Review

In February 2021, the FCA published its MiFID II Product Governance Multi-Firm Review¹⁶. The review assessed how firms consider the MiFID II product governance regime (found in PROD) when manufacturing and providing products and how far firms consider the interests of end investors throughout the product lifecycle. Although the rules of PROD apply to ACDs as guidance¹⁷, as MiFID does not directly apply to ACDs, the commercial reality is that PROD is a key obligation of MiFID firms that are

¹² There were no public reports published following the first two reviews, with affected firms receiving individual letters. The report for the 2020/2021 review can be found at <https://www.fca.org.uk/publications/multi-firm-reviews/host-authorized-fund-management-firms>

¹³ <https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf>

¹⁴ <https://www.fca.org.uk/publication/finalised-guidance/fg18-03.pdf> which replaced the existing 2014 guidance FG14/4.

¹⁵ <https://www.fca.org.uk/publication/policy/ps19-04.pdf>

¹⁶ <https://www.fca.org.uk/publications/multi-firm-reviews/mifid-ii-product-governance-review>

¹⁷ PROD 1.3.2 R

distributors, who require information from product manufacturers to comply with their duties. Compliance with PROD by an ACD is therefore expected by distributors and other market participants. Alternatively, the agreement between the product manufacturer and distributor may include an obligation to undertake a target market assessment. In the case where the ACD is the co-manufacturer of the fund alongside a MiFID firm, the co-manufacturing agreement will legally oblige the ACD to comply with the PROD requirements.

In terms of findings, the FCA stated that there is significant scope for asset managers to improve their product governance arrangements. However, across all key areas of focus, the FCA did not go into detail in terms of how firms should consider the findings, leaving it to firms to review their own product governance processes and procedures.

The review grouped observations into four key areas:

- product design (including the target market and conflicts of interest);
- product testing (including scenario and stress testing as well as cost disclosure);
- distributors (including due diligence, Management Information and information from distributors back to the asset manager); and
- governance and oversight (including second line of defence, role of committees and the ACD Board, with specific focus on iNEDs).

2019/2020 FCA Multi-Firm Review of Independent ACDs

The latest FCA review of independent ACDs took place between 2019 and 2020, with the results being published in June 2021¹⁸. The overarching aim of the review was to test the viability of independent ACD business models and assess whether conflicts of interest were being effectively managed, ACDs acted in investors' best interests and that they fully understood their responsibilities. The review looked at governance, controls, monitoring and the management of risks in the business model.

Although the review concentrated on independent ACDs, the FCA made it clear that the findings should be considered by internal ACDs and applied to their business model.

In June 2020, the FCA published finalised guidance (FG20/1¹⁹) for all UK regulated firms, setting out its expectations of the practices firms should adopt in their assessments of adequate financial resources.

This was followed in July 2021 with the FCA's findings on its review of Assessments of Value (AoV²⁰). The FCA found that most of the AFMs they reviewed had not implemented the AOV arrangements required to comply with the rules.

2022 Consumer Duty

The FCA published its policy statement and handbook guidance on an overarching Consumer Duty in July 2022.²¹ This requires all firms to comply with a new regulatory principle, overlaying the existing regulatory requirements for the investment fund industry, while continuing alongside key existing retail market-focused fund regulation such as the AoV, product governance and investor disclosure regimes. The IA is undertaking detailed analysis and member discussion in order to provide support for firms in interpreting how best to implement and operate the Consumer Duty. This guidance document will evolve over the next six months to reflect that analysis and

¹⁸ <https://www.fca.org.uk/publications/multi-firm-reviews/host-authorised-fund-management-firms>

¹⁹ <https://www.fca.org.uk/publication/finalised-guidance/fg20-1.pdf>

²⁰ <https://www.fca.org.uk/publications/multi-firm-reviews/authorised-fund-managers-assessments-their-funds-value>

²¹ <https://www.fca.org.uk/publications/policy-statements/ps22-9-new-consumer-duty>

discussion. We expect that this will have an impact on a number of areas of the document, such as customer disclosure.

2. Duties of an ACD

Under the overarching duty of acting in unitholders' best interests, the ACD's role can be broken down into the following key areas:

Product Design and Manufacture²²

- Ensures the product is designed to meet the needs of an identified target market (PROD 3.2.1 R (1)).
- Specifies the fund design and characteristics such that expectations and objectives are clear, capable of being achieved and with costs and charges that represent good value to investors.
- Ensures any delegates appointed to perform functions such as investment management and distribution are appropriately and demonstrably skilled and resourced to deliver good outcomes for investors in the fund (SYSC 8.1.8 R 1).

Ongoing governance and operational oversight

- Ensures the fund is managed to its mandate and makes available information about the target market and appropriate channels for distribution of the fund (COLL 6.6.3 R (3)(a) and PROD 3.2.16 R (4)).
- Arranges the appointment of a qualified and capable person to perform any delegated functions and the effective monitoring of these delegates. These functions may include investment management, transfer agency, fund administration, fund accounting and marketing (COLL 6.6.15A R(2)).
- Ensures that any delegated functions are governed properly by legal agreements and documentation and are performed properly and within the applicable regulations (SYSC 8.1.9 R).
- Keeps all funds under review to ensure they remain viable, determine whether the payments are justified in the context of the overall value delivered to investors, and that the product continues to meet the needs of the target market it has been designed for (COLL 6.6.20 R – 6.6.24 G, PROD 3.2.13 R and PROD 3.2.19 R).

Risk management

- Ensures that the risks inherent in the fund and within the ACD, including investment, operational and liquidity risk, are monitored and managed effectively (SYSC 4.1.1 R, COLL 6.12.3 R and FUND 3.7.5 R(2)(b)) and the investment portfolio complies with the regulations, the fund's investment objective, policy and strategy, and its risk limits. The risk management function must be separate to the investment management function, i.e. the same teams must not make the investment decisions and oversee the risks.

Value assessment

- Produces an annual assessment of value, which looks at whether the fees a fund pays are justified in the context of the overall value provided to investors. If this is found not to be the case, the ACD needs to take remedial action in order to ensure that it is acting in the best interests of its client, or delivering a fair pricing model and preventing undue costs being charged. The Chair of the governing body has a prescribed responsibility for the value assessment (COLL 6.6.20 R – 6.6.24 G and COLL 6.6A.2R, COBS 2.1.1R or COBS 2.1.4R).

Investor disclosure

- Produces regulatory documentation, such as a Prospectus and Key Investor Information Document (KIID), which tells investors the features of the fund. Any marketing material may be produced by the sponsor or distributor (COLL 4.2 and 4.7 and PROD 3.2.16 R (1)).

²² In some cases, another firm within the same group as the ACD may be the product manufacturer, in which case product manufacturing activities may be delegated.

- Produces annual and semi-annual reports and accounts for each authorised fund. This will include fund investment holdings (including valuation and change in valuation) and details of any assets that have been bought and sold. The report, which is produced in accordance with international accounting standards and the IA SORP, can also contain important information on any changes that have been made over the year, e.g. a fund's fees, and may contain the value assessment. The financial statements contained within the annual report are audited by a fully independent auditor, who is appointed by the ACD (COLL 4.5).

Routine operational integrity

- Ensures that any changes made to the fund, e.g. the types of asset in which the fund invests, are not made until appropriate approval has been granted from the FCA and that investors have, where required, approved the change at an Extraordinary General Meeting (EGM), or otherwise been appropriately informed. However, some changes are so minor that investors and the FCA may only need to be told about them after they have been made (COLL 4.3).
- Makes sure that the investment manager abides by the detailed FCA rules and provisions and restrictions in the prospectus about what they can invest in for the fund (SYSC 8.1.8 R(2), SYSC 8.1.13 R, COLL 6.6.3 R(3)(a)) and FUND 3.10.
- Makes sure that investors have the facility to buy and sell units/shares in the fund (COLL 6.2.16 R). Where the ACD is responsible for the investor register,²³ it must take reasonable steps to update the register when notified of changes (COLL 6.4 R)²⁴. Although this service is often outsourced to another company (the Transfer Agent), this does not affect responsibility for maintaining the register. Delegations must therefore be carefully monitored.
- Makes sure that an accurate value is given to assets held by the fund, to ensure that investors buying or selling fund units/shares obtain the right price (COLL 6.3.3 R and FUND 3.9). Again, this function is often outsourced to another company (the Fund Accountant), but the ACD maintains responsibility and must therefore oversee their processes. The ACD should retain the necessary knowledge and expertise to perform effective oversight of this function, particularly where a fund is holding real or private assets.
- Arrange to pay any fees and charges from the funds (subject to approval by the independent depositary) (COLL 6.7).
- Makes sure that the fund adheres to laws and regulations to combat money laundering and the financing of terror applicable to the United Kingdom (SYSC 6.3 and any obligations imposed under the depositary agreement where this is one of the mandatory terms – UCITS V Level 2, Article 2(k) or AIFMD Level 2, Article 83(m)).
- Makes sure that the identity of the fund's investors is established, in accordance with Financial Action Task Force (FATF) and other relevant requirements.

Other duties

- Identifies, monitors and manages any conflicts of interest arising from the fund and its management (SYSC 10.1.17 – 10.1.18 and 10.1.23 – 10.1.24 R).
- Appoints and liaises with the depositary, evidencing appointment with a written contract (COLL 6.6A.7 R, COLL 6.6A.11 R, FUND 3.11.4 R and FUND 3.11.19 R).
- Reports breaches in relation to the fund to the depositary, and, in more serious cases, the FCA (COLL 6.2.12 G 3, COLL 6.3.6 G 4, COLL 6.3.3 R(3) and COLL 6.6.14 R(2)).
- Liaises with the FCA on matters relating to the ACD and the fund.

²³ In some cases, the depositary can be responsible for the register, although this would largely be the case for legacy fund arrangements. In practice, maintenance of the register is delegated to a transfer agent.

²⁴ GDPR is likely to be relevant in this context also, although by which ever entity is the data controller.

3. Good Practice

It is crucial that ACDs understand their responsibilities for the funds they operate.

As such, ACDs need adequate governance, controls and resources to carry out their role.

Governance and Oversight

Overview

An ACD must:

- Have a clear purpose and strategy (SYSC 3.2.17 G)
- Be well resourced in terms of systems, staff and expertise (COND 2.4.1A, SYSC 3)
- Have clear and relevant asset management experience for oversight of delegated functions, such as investment management, distribution, administration and fund accounting (SYSC 3.1.6 R)
- Have a clear organisational structure (SYSC 3.2.2 G)
- Have effective risk management processes (SYSC 3.1.2A, SYSC 4.1.1 R)
- Have internal control mechanisms (SYSC 4.1.1 R, SYSC 12.1.8 R)
- Keep orderly records of the business and internal organisation (SYSC 3.2.20 R)
- Keep detailed board meeting minutes and full records of follow-up actions (SYSC 9.1)
- Assess and periodically review policies, arrangements and procedures (SYSC 3.2.16 G (2))
- Recognise and control inherent conflicts of interest and regularly review and update the Conflicts of Interest Register (SYSC 10.1)
- Conduct a meaningful assessment of value, at least annually (COLL 6.2.20 R)

A firm should be satisfied that and certify its senior managers are and remain fit and proper²⁵, assessing senior managers on at least an annual basis. An ACD's senior management should be able to demonstrate good governance throughout the organisation, supporting a clear purpose and strategy. The ACD should be well resourced in terms of systems, staff and staff expertise, and have clear and relevant asset management experience for overseeing delegated third-party investment managers. Similarly, where other functions are delegated, such as distribution, fund administration and fund accounting, the ACD should have sufficient knowledge and experience to oversee the delegates.

An ACD is required to have robust governance arrangements. The arrangements must include:

- clear organisational structure with clear lines of responsibility
- effective processes to control the risks to which the ACD is or might be exposed
- internal control mechanisms
- orderly records of the ACD's business and internal organisation must be kept.

Board effectiveness

Independent members of the ACD's governing body must act in the interests of unitholders and the terms of an iNED's appointment must ensure that they are free to act in unitholders' best interests without breaching the terms of their employment. INEDs, amongst other obligations, are required to provide effective challenge of the ACD's processes, including the challenging of potential conflicts and their management. INEDs should consider whether the Executive Directors have taken the relevant factors into account when reaching a decision and it is imperative that they ask Executive Directors to justify a decision where there is any doubt. ACDs must keep detailed minutes of board and other governance committee meetings, which should detail discussions held, decisions made and challenge presented. Where follow-up actions are identified, there should be full records kept of the work undertaken to complete these actions.

²⁵ SYSC 23.3.3 G

An ACD is required to employ senior personnel that are sufficiently experienced to ensure the sound and prudent management of the firm. These staff assess and periodically review the effectiveness of the ACD's policies, arrangements and procedures to comply with its obligations under the regulatory system and take appropriate measures to resolve any deficiencies. An ACD that is a core or enhanced scope SMCR firm should allocate certain specified management responsibilities ('prescribed responsibilities') amongst its SMF managers. The 21 prescribed responsibilities are set out under SYSC 24.2.6R. The FCA expects that these responsibilities will be allocated to personnel who are sufficiently senior and credible and who have sufficient resources and authority to be able to exercise their management and oversight responsibilities effectively²⁶. Certain of those responsibilities²⁷ should be allocated to an INED, with the remainder allocated to an SMF manager who performs executive functions for the firm. It is expected that these responsibilities will be allocated between several SMF managers.

Oversight of delegates, including third-party investment managers, is required to consider the interests of fund investors. These delegates should be held to account to achieve fair results for investors. An ACD should be prepared to make decisions in the interest of the schemes they operate and of investors, disregarding the impact on their business.

Conflicts of Interest

A firm's senior management must clearly recognise and control the conflicts of interest inherent in the business model, whether the ACD is internal or independent. The Conflicts of Interest Register should be escalated to the Board for discussion and challenge and should be regularly reviewed and updated.

In broad terms, firms are required to have an effective framework to identify relevant conflicts of interest and to take meaningful steps to avoid or prevent any conflicts of interest which risk damaging the interests of investors in the funds operated by the firm. Where ACDs cannot avoid or prevent conflicts, they need to manage and monitor them to ensure that the funds, and the funds' investors are treated fairly. Where it is not possible to prevent a conflict of interest risking damage to the interests of the authorised funds or investors, ACDs are required to disclose information about the conflict to the fund investors.

Assessment of value²⁸

FCA rules require an ACD to conduct an assessment, at least annually, of each fund it manages to identify whether the charges paid out of the scheme property are justified in the context of the overall value delivered to unitholders.

Examples of ways where ACDs may look to provide more value to investors is with the provision of additional services or to negotiate break points in fees paid to investment managers, depositaries, transfer agents and fund accountants. In some cases, the amounts involved, particularly in relation to payments for investment management can be significant.

ACDs are obliged to seek to achieve improved value for investors through delivery of economies of scale, which may include reducing costs (or using fee tiering) for any party as assets increase and which are to the benefit of investors in the funds.

At the heart of the assessment of value are the seven review considerations. Firms should ensure that the review fully covers each consideration and that any comparisons between different share classes or

²⁶ SYSC 24.3.1G

²⁷ SYSC 24.3.2 G

²⁸ Further detail can be found in the IA's Guidance on the Value Assessment & Reporting Requirements (see Appendix).

funds e.g. performance, are made between those with similar features and rights. ACDs are required to include the assessments and findings on each of the seven minimum criteria, along with any other criteria that they deem relevant, in their annual reports to investors on the value assessment.

The FCA expects the assessment of value to take place at share class level, rather than just at fund level, as this will highlight examples of share classes that have provided poor value.

When considering a fund's performance, an ACD is required to consider its investment objective, policy, strategy and fees, as well as expectations set in investor communications and financial promotions.

Any assumptions made by an ACD in the AoV process must be justified and documented.

The FCA expects ACDs to consider fees and charges incurred by investors in the context of costs incurred by the ACD in operating the fund, rather than solely comparing total fund charges against those of competitors' funds.

ACDs must employ clearly defined procedures and metrics for collating and presenting information to ACD Boards. This could include providing clear, well-structured and easy-to-navigate reports that provide useful charts and graphics. As with the Governance section above, iNEDs should be well-informed on the rules surrounding and purpose of the Assessment of Value and the ACD's funds and AoV frameworks. This will allow iNEDs to provide a robust challenge in the Assessment of Value process.

Product governance²⁹

Overview

An ACD must:

- Consider the impact of their action, or inaction, in established processes and procedures on investors by, amongst other things, stress testing (PROD 3.2.12 R).
- Design, understand and perform ongoing reviews of the features of funds manufactured, including distribution channels (PROD 3.2.19 R).
- Have processes in place to select distribution channels (PROD 3.2.2 G).
- Identify fund target markets and ensure funds remain appropriate for those target markets (PROD 3.2.1 R, PROD 3.2.8 R, PROD 3.2.10 R).
- Have systems and controls in place to manage the risks posed by the fund design process (PROD 3.2.5 G).
- Provide appropriate information to distributors (PROD 3.2.16 R).
- Provide appropriate information to direct investors (COLL 4, COBS 4).
- Have effective complaints handling procedures (DISP).
- Have effective processes in place in relation to financial promotions (COBS 4).

An ACD is responsible for each fund it manages at all stages of the fund's lifecycle, from the pre-authorisation stage to the fund's wind-up.

An ACD is required to consider the impact of their action (or inaction) on the investor at various stages of the fund's lifecycle. This will include addressing the fair treatment of investors at the following stages:

- design and governance;
- identifying target markets;
- marketing and promotion;
- sales and advice processes;
- after-sales information and service; and

²⁹ Further detail can be found in the IA Guidance on MiFID II Product Governance (see Appendix).

- complaints handling.

One area that the ACD will wish to consider in the realm of product governance is the distribution of the fund. An ACD will allow a distributor, often through a contractual agreement, to distribute its funds to investors, usually retail investors (the 'end investor'). In such instances, the ACD may not have a contractual or other relationship with the end investor. However, the ACD and any joint manufacturer should act with due skill, care and diligence in designing its funds. The skill, care and diligence that are 'due' will be determined taking all the circumstances into account. These may include the manufacturer's knowledge of whether the product or service is provided to an institutional, rather than a retail or professional investor, and the information needs of the firm.

In addition, any information communicated to the distributor should be communicated in a way that is not misleading and that can be understood by retail investors, if it is likely that the end investor is a retail investor.

It may be prudent for an ACD to agree with distributors how to apportion responsibilities and what information should be provided by one party to another. Both parties should be aware of their regulatory responsibilities in this area and the arrangements should be reasonable and clear to both parties. The agreement should be properly recorded, and systems and controls should be in place to monitor whether the agreement continues to be appropriate in the circumstances.

When undertaking product or service design, an ACD:

1. must identify the target market, namely which types of customer the product or service is likely to be suitable (and not suitable) for;
2. must stress-test the product or service to identify how it might perform in a range of market environments and how the customer could be affected; and
3. must have in place systems and controls to manage adequately the risks posed by product or service design.

When providing information to distributors, an ACD:

1. must make clear if the information is not intended for investor use; and
2. must ensure the information is sufficient, appropriate and comprehensible in substance and form, including considering whether it will enable distributors to understand it enough to give suitable advice (where advice is given) and to extract any relevant information and communicate it to the end customer.

As part of meeting this standard, an ACD should, with regard to each distribution channel or type of distributor, consider what information distributors of that type already have, their likely level of knowledge and understanding, their information needs and what form or medium would best meet those needs (which could include discussions, written material or training as appropriate).

When providing information to investors directly, an ACD:

1. must pay regard to its target market, including the likely level of financial capability;
2. must take account of what information the customer needs to understand the product or service, its purpose and the risks, and communicate information in a way that is clear, fair and not misleading; and
3. must have in place systems and controls to ensure that information is provided to customers in accordance with applicable regulations.

When selecting distribution channels, an ACD:

1. must decide whether this is a product where customers would be wise to seek advice;
2. must review how what is occurring in practice corresponds to (or deviates from) what was originally planned or envisaged for the distribution of its products or services given the target

market. This involves collecting and analysing appropriate Management Information (MI) such that the firm can detect patterns in distribution as compared with the planned target market, and can assess the performance of the distribution channels through which its products or services are being distributed;

3. must provide further information or training to the distributor, if the distributor so asks; and
4. must act when it has concerns, for example by ceasing to use a particular distribution channel.

Post-sale, an ACD:

1. in supplying information direct to the investor, must ensure that the information is communicated in a way which is clear, fair and not misleading;
2. must periodically review funds whose performance may vary materially to check whether the fund is continuing to meet the general needs of the target market that it was designed for, or whether the fund's performance will be significantly different from what the ACD originally expected and communicated to the distributor or investor at the time of the sale. If this occurs, the ACD must consider what action to take, such as whether and how to inform the investor of this (to the extent the investor could not reasonably have been aware) and of their option to seek advice, and whether to cease distributing the fund;
3. must communicate to the investor contractual 'breakpoints' such as the end of a long tie-in period that may have a material impact on an investor that the investor cannot reasonably be expected to recall or know about already; and
4. must establish, implement and maintain effective and transparent investor and distributor complaint-handling systems.

ACDs must also have systems and controls in place to ensure that any financial promotions it issues relating to a fund are fair, clear and not misleading and provide all of the relevant information needed. Where marketing and distribution are delegated, the ACD is required to ensure they have appropriate due diligence processes in place to oversee activities and that the delegate has systems and controls in place to carry out that activity in line with the FCA rules and principles.

Due diligence of delegates, including investment managers

Overview

An ACD must:

- have the necessary resources and expertise to monitor delegation arrangements (SYSC 8, FUND 3.10.9 EU (1)(a));
- be able to manage the risks associated with delegation (SYSC 8.1.8 R (3), FUND 3.10.9 EU (1)(a));
- in broad terms, act in the best interests of unitholders (COBS 2.1.4 R (2), COLL 6.6.15A R (2)(d), COLL 6.6A.2 R);
- have processes to consider how it complies with requirements when preparing fund applications (COLL 4.3.13 G and PRIN 11); and
- have processes in place for the initial and ongoing due diligence of delegates (COLL 6.6.15A R and FUND 3.10.2 R).

The FCA's Principles require ACDs to conduct their business with due skill, care and diligence and to take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems.

There are also specific requirements for ACDs who delegate investment management to a third party. ACDs are required to have the necessary resource and expertise to monitor delegation arrangements, managing associated risks and must ensure that delegates manage the fund in investors' best interests, e.g. by ensuring that investors are not subject to undue costs and charges.

Due diligence processes may be universal, but some may relate to specific delegated functions and

products. ACDs are required to ensure that any generic processes are capable of being tailored for particular functions or fund types.

When preparing an application to the FCA for authorisation of a new fund to be managed by the ACD, or an application to act as ACD for an existing fund, a firm will need to consider how it will comply with these requirements.

An ACD will need to establish a set process for both the initial and ongoing due diligence of delegates. The process should aim to gather enough detailed information from the delegate to be able to assess and understand the strategy and activities. ACDs must be able to adequately understand the funds for which they will have responsibility. Where ACDs identify risks or inconsistencies, they need to be addressed adequately.

As part of this process, ACDs must be prepared to effectively challenge proposals and information received from sponsors and investment managers throughout the due diligence process. This usually involves ensuring that delegates have written policies and procedures in place, although these are not strictly required. ACDs should practically observe and test how effectively these policies and procedures are implemented in practice and whether they produce good outcomes. ACDs should perform an in-depth analysis of the delegated third-party investment managers' expertise, track record or investment process during the take on process.

ACDs must ensure that they fully understand the fund, its strategy and assets and that there are adequate systems and controls in place to operate the funds, including at all relevant parties before applications are submitted to the FCA.

Ongoing oversight of delegates

Overview

An ACD must:

- have processes, resources and expertise in place to effectively monitor delegates (SYSC 8, FUND 3.10.2 R);
- have a procedure in place to withdraw the delegation mandate if in the interests of investors (SYSC 8.1.8 R (7));
- have a procedure in place to replace a delegate at short notice in the case of the delegate's failure (SYSC 13.9.8 G);
- be sufficiently skilled and experienced to understand each fund's investment strategies and characteristics (COLL 6.6A.4 R (2) and (5), COLL 6.10.2 R (4) and (5), SYSC 4.2.1B R);
- ensure that marketing materials are clear, fair and not misleading (COBS 4.2.1 R); and
- have sufficient performance and risk oversight processes in place (COLL 6.6.21 R, SYSC 13.9.4 G).

In addition, the FCA has suggested that it is good practice to link the questions asked on the onboarding of a fund with the tracking of outcomes as part of the ongoing review.

As detailed above, an ACD can delegate investment management to third parties, but this does not change the AFM's regulatory responsibility for funds or fund investors. Regulatory responsibility cannot be delegated, so it is imperative that the ACD is comfortable that the investment manager is complying with all relevant regulatory responsibilities on the ACD's behalf.

Where an ACD delegates investment management to a third party it must ensure that it can effectively monitor them and must retain the necessary resources and expertise to do so. The delegation arrangement must not prevent the ACD from acting, or the fund from being managed, in the best interests of investors. The AFM must be able to give further instructions to the delegate investment manager, obtain access to its people, documentation and processes for effective oversight and withdraw

the delegation mandate if in the interests of investors.

Oversight

After a fund is onboarded or a new delegation takes effect, an ACD will oversee delegates on an ongoing basis. It is essential that there is a link between the questions asked during the onboarding of a fund or investment manager and the subsequent tracking of outcomes. Specifically:

- analysis of any model portfolio versus the actual portfolio ex-post;
- analysis of the actual distribution channels of the fund versus the planned distribution;
- monitoring of the evolution of the Ongoing Charges Figure (OCF) against the charges modelled initially;
- analysis of how the investment manager could achieve stated performance or income targets
- resilience of the fund in volatile market conditions and scenarios that may affect how the fund performs;
- stress testing against adverse market conditions, asset-specific stresses and risks from the investor base; and
- escalation of issues from the product governance committees to the management committee and on to the board.

Investment strategies

Staff at ACDs need to be sufficiently skilled and experienced in, and understand the characteristics of, the financial instruments and other asset classes found within the funds it oversees, the investment services provided, the characteristics and objectives of the funds, as well as the analysis and investment risk and performance. ACDs must have appropriate resources, including staff responsible for fund oversight having direct and relevant experience of the types of instrument or asset classes and strategies being used. This could include a formal qualification or first-hand direct experience of investing or investment risk oversight.

ACDs that do not promote the funds themselves must ensure that any information investment managers or other sponsors give investors in their wider marketing material presents a fair and clear account of the features of the fund, in particular charges, including any portfolio transaction costs.

ACDs are required to obtain detailed information from investment managers, including:

- how they plan to invest to meet fund objectives; and
- how they perform in different risk environments against fund objectives, benchmarks and peers.

For performance and risk oversight, ACDs are required to:

- operate with a clear understanding of tolerance levels for each of the indicators being used, referenced to acceptable consumer outcomes;
- have clear lines of escalation for issues that fall outside of tolerance, and clear tracking metrics to ensure issues are followed to conclusion;
- use a risk metric that is determined to be appropriate for each fund, rather than operating with a 'one size fits all' approach; and
- ensure the frequency of data and the time periods used are consistent with the fund's objectives. For example, only looking at the previous month's performance is inconsistent with medium term return objectives

Financial Resources

Overview

An ACD must:

- have a suitable business model (COND 2.7);
- have appropriate resources (both financial and non-financial) (COND 2.4);

- have a risk framework and assessment in place (SYSC 4.1.1 R, SYSC 7.1.1 R, SYSC 21.1);
- regularly review the risk assessment and framework (SYSC 7.1.5 R);
- consider forward-looking financial projections and strategic plans of at least three years (FCA FG 20/1 – Our framework: assessing adequate financial resources);
- have a meaningful stress-testing process and consider implementing a wind-down plan (FCA FG 20/1 – Our framework: assessing adequate financial resources and The Wind-down Planning Guide); and
- have a process in place to ensure regulatory reporting is timely, complete and accurate (SUP).

In addition, where support is received and relied upon for capital adequacy from a parent, firms may wish to consider having a formal agreement in place to ensure the parent will stand behind the firm should the need for capital arise.

To meet the Threshold Conditions, it is important for firms to have a suitable business model and appropriate resources (both financial and non-financial) for the nature and scale of the business they carry out. Firms must be well capitalised, having assessed their risks and the harm their activities may pose and considered the resources they need to operate throughout the economic cycle.

Principle 4 requires an ACD to maintain adequate financial resources. This will include adequately charging to enable it to perform services effectively. An ACD must invest in systems, controls and people to enable it to execute its role as an ACD effectively.

Risk Framework and Assessment

The FCA requires an ACD to have a risk framework and assessment in place. The framework should cover all aspects of the business and the ACD has to be able to demonstrate its effectiveness in identifying, assessing and mitigating risks. The framework must be clearly owned by a sufficiently senior committee, be subject to clear governance and be widely used within the business.

Firms need to understand the risks in their activities so that they can detect, identify, and rectify problems themselves. This can be accomplished by firms ensuring that their systems and controls, governance and culture enable them to take effective steps to prevent harm from occurring.

The risk framework and assessment should contain a clear risk appetite statement, allowing management to identify if the firm is operating outside of its risk tolerance. Firms will then perform an assessment of the risks that arise or may arise from their activities and the harm they may pose to investors, the wider market or the ACD across all risk types, including operational risk. As good practice, the FCA would like to see regulated firms use capital risk assessments as a tool in their ongoing operations and decision-making processes. This would include regular reviews of the risk framework and assessment throughout the economic cycle, including the types of risk applicable to the business, to reflect growth and change within the business. As part of this a firm will assess how much capital they need throughout the economic cycle.

The FCA expects firms to consider forward-looking financial projections and strategic plans, under both business-as-usual and stressed circumstances. It is the FCA's view that this helps a firm to understand the viability risks to its business model and the sustainability of its strategy over a period of at least three years.

Stress testing and wind-down planning

As with all regulated firms, the FCA expects to see ACDs have a meaningful stress-testing process and encourages them to have credible wind-down plan, with realistic timescales and assessments of how the firm maintains resources for an orderly exit from the market. Without a credible plan, a firm risks a disorderly exit from the market, including the increased risk of harm to fund investors and the funds market in general. However, it may not be appropriate for all firms to have a plan and the FCA

encourages a best practice approach in this area, with firms considering factors such as their size, complexity and exposure to the market when deciding on the existence and scope of a plan.

Stress testing should consider a variety of stressed conditions that a firm may face, the resilience of the firm under each of these conditions and action it may take, including winding-down. A failure to reach forecasted growth may be one scenario considered, but is only one of many stressed scenarios that an ACD can face.

A firm's wind-down plan should be documented and approved by the firm's governing body (e.g. Board of Directors), including aspects such as scenarios that would prompt an orderly wind-down of the business, the timeline for wind-down, the treatment of funds managed by the ACD, the treatment of delegates and third parties and financial and non-financial resources required. Any assumptions made must be clearly documented, including the rationale for the assumption.

Firms should refer to the [FCA's FG20/1 – our framework: assessing adequate financial resources](#), as well as its [Wind-down Planning Guide](#), contained in the Handbook.

Reliance on professional indemnity insurance and/or parent support

An ACD may rely on the support of a parent firm to maintain capital adequacy. In that regard, the FCA encourages the ACD and parent to have formal arrangements in place, and the ACD may wish to consider the impact should access to funding be delayed or unavailable.

It is common for firms to use Professional Indemnity Insurance (PII) to manage the risks from their activities. Though insurance can form part of an appropriate risk mitigation approach, it is not a substitute for adequately assessing risk and maintaining adequate financial resources in all circumstances. This is because many scenarios may not be covered by PII policies, due to exclusions. Additionally, a successful insurance claim would not likely be paid immediately.

Regulatory reporting

ACDs must ensure that any regulatory reporting is timely, complete and accurate. The FCA uses the data reported to analyse a sector or a group of firms and the information in these returns also forms an integral part of firms' risk management frameworks.

Conflicts of Interest³⁰

When an independent ACD model is used, they must also manage the commercial realities of this process. The investment manager selects the ACD and in the majority of cases is the primary contact for the investors. In this case, the investment manager would be indirectly ensuring that the ACD is paid for their service through the fund's fees and has the ability to replace the ACD. Robust procedures are therefore required to be in place to ensure that there cannot be undue influence over the ACD by the investment manager and the ACD must have controls in place to manage this conflict.

An ACD may also manage funds with a sponsor, which may or may not be the same firm as the investment manager. The perceived need not to inconvenience the sponsor could lead to some ACDs to adopt a 'hands off' approach.

Internal ACDs appoint a portfolio management entity in the same group, typically their parent entity (and sole or largest shareholder) to perform investment management of their funds. Their governing body may comprise the same personnel as the investment manager and they may not have any distinct resources. This would give rise to a conflict regarding the independence of the ACD and its ability to perform fully independent oversight of the investment manager, which will need to be managed

³⁰ SYSC 10

appropriately.

ACDs may experience conflicts between delegates, where the needs of delegates differ, or processes established with one delegate are not agreed by another.

Independent ACDs may have different fee structures in place for funds that are managed by different investment manager delegates. An ACD will need to consider whether the difference in fee structures is justified, bearing in mind the individual circumstances of each fund and its investors. Where changes are made for one or more funds, changes to other funds managed by the ACD should be considered. This conflict will be one aspect that is considered during the value assessment process.

There may be conflicts in the fee structures agreed with other external parties, such as the depositary, custodian or auditor. Fee structures are generally complex and are typically agreed on the basis of all of the funds subject to the external party's appointment. This will be to the benefit of some funds, but could lead to a higher OCF for others.

An ACD that is part of a group structure will be party to commercially sensitive information surrounding funds managed and, in some cases, in relation to external delegates. The ACD will need to ensure that there are arrangements in place to ensure that such information is not shared within the wider group.

There may be times where there is a need to suspend or intervene in a fund's management in investors' best interests. However, such intervention or a fund suspension can result in media attention for the ACD. It is important that such attention does not influence the decision of the ACD to intervene or suspend, or to lift a suspension. Instead, the best interests of investors will always be the paramount factor in such a decision.

A depositary may itself be conflicted, due to its duty of oversight of the ACD who appoints them.

Appendix – IA Guidance and Model Documentation

Guidance

Guidance on:

- Fund Processing
- Charges and costs
- Closing Funds
- Reports and Accounts
- Revenue Recognitions
- Securities Financing Transactions
- Valuation and Pricing
- Yield Disclosure

can be found on the centralised IA Guidance page <https://www.theia.org/industry-policy/positions/guidance-and-good-practice-8>

Other guidance:

- [Local authority client categorisation under MiFID II](#)
- [Authorised funds – a regulatory guide](#)
- [Classification of Change Events](#)
- [Fund Liquidity Guidance](#)
- [Fund Suspension Guide](#)
- [Market Timing Guidelines](#)
- [CAIF Guide](#)
- [Value Assessment FAQs](#)
- [Eligible Assets FAQs](#)
- [Guide to Risk Management Processes for Managers of UK Authorised Collective Investment Schemes](#)
- [Fund Accounting documents](#)
- [Disclosure of costs and charges](#)
- [SORP](#)
- [Fair Value Pricing](#)
- [Data delivery frameworks \(public\)](#)
- [Costs and charges \(public\)](#)
- [MiFID II Product Governance](#)
- [Fund Communication Guidance](#)
- [Benchmarks Disclosure and Reporting](#)
- [Guidance Principles on Outsourcing](#)

Model Documentation

Model Documentation:

- Model Electronic Renunciation Agreement for Authorised Funds
- Stock Transfer Form for Authorised Funds
- Stock Transfer Form for Authorised Funds
- Guidance Notes
- Guidance Notes
- Model Trust Deed/ACS Deed/Instrument

can be found [here](#).

- [CAIF Model Deed](#)



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