THE INVESTMENT ASSOCIATION

FCA consultation on further remedies – Asset Management Market Study

CP18/9

Response from the Investment Association[1]

5 July 2018

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[1] The Investment Association is the trade body that represents UK investment managers, whose 240 members collectively manage over £6.9 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to build people's resilience to financial adversity, help people achieve their financial aspirations, enable people to maintain a decent standard of living as they grow older and contribute to economic growth through the efficient allocation of capital.

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets. More information can be viewed on our website.

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1. INTRODUCTION AND SCOPE

1.1 The IA supports the goals of CP18/9 and we look forward to working with the FCA and stakeholders on ensuring the best possible information is available on fund objectives, how those objectives are achieved and how performance against those objectives is measured. Our response outlines how the FCA can set expectations for fund documentation in a way that achieves greater clarity of objectives without creating a potentially complex conceptual framework that may not align with the wider goal of more accessible, consumer-friendly language.

1.2 The existing three-level approach to benchmark disclosure could be made clearer. In particular, the requirements around the explanation of constraints may not be straightforward for investors to understand or for fund managers to implement. We propose two key changes. First, a simpler approach to the identification of constraints. Secondly, a recognition that comparators are different in nature to targets and constraints, and, significantly, may be determined by investors, advisers and platforms, i.e. other third parties, rather than fund managers.

1.3 Further work is needed to link the proposals within CP18/9 to what we observe happening in the wider market and specifically how buying decisions are actually being made. In this regard, there are a number of key points that need to be considered.

Role of intermediaries

1.3.1 Few investors buy their funds directly from fund managers. We estimate that of the £243bn in gross retail sales in 2017, only 7.3% were direct. Those who do not rely on advisers or discretionary fund managers to help them manage their investments are likely to have arrangements to administer their fund holdings through a third party online platform.

1.3.2 The information set available via platforms and advisers is broader than the KIID and fund factsheets, which are the main fund documents made available by fund managers to investors on platforms. Additional factsheets may also be produced by third parties which means that investors will often encounter a range of information about a given fund on the relevant landing page of a platform. It would be helpful to get some clarity on whether documents by third parties would be subject to the same requirements.

Role of regulated documents

1.3.3 Market research conducted by The Wisdom Council and shared during the FCA Fund Objectives Working Group discussions, indicates that consumers find KIIDs to be un-engaging (although that might be partly because of the language used). This raises the broader question for regulators and industry to consider how best to communicate key information to investors.

Funds within a wider portfolio

1.3.4 Many investors are likely to hold more than one fund within a wider portfolio, and may need assistance at the level of the distributor to gain an understanding of the objectives and performance of their overall portfolio rather than focus at a fund level. There will be limitations on how useful information on an individual fund will be for investors in the context of their overall portfolio construction, which is, arguably, at least as important as that of the underlying funds.

1.4 We therefore see this CP as an important starting point in ensuring that meaningful information is available to investors. Ultimately, well informed investors are best placed to drive competition in the market place, which is the aim of the asset management market study remedies. Fund managers will ensure that communication materials provide clear and useful information to their investors and those acting on their behalf.

1.5 This will be complemented by work the IA is carrying out, as stated in CP18/9 paragraph 3.22. The IA has committed to an industry-led workstream to enhance communication materials. The aim is to develop industry guidance, in conjunction with consumer testing, as to how objectives may be explained more clearly to investors. This work stream has three strands:

- Clarity of language in objectives, policy and strategy;
- Investor expectations regarding performance reporting, risk and time horizons; and
- Assessing useful information for consumers.

1.6 The IA's Investor Communications Working Group (ICWG) is taking this work forward and the IA welcomes the FCA's participation as an observer to that Group. Output is expected in H2 2018 to coincide with the finalised rules and guidance resulting from CP18/9.

1.7 This will need to be complemented by a similar approach by distributors and advisers and cover all elements of the investor's portfolio. The IA and fund management firms look forward to further dialogue with the FCA, distributors and advisers about how to ensure consistency and effective communication throughout the delivery chain.

1.8 The Investment Platforms Market Study may provide the necessary link between the current CP and the work the IA is undertaking. It is important that the remedies set out in CP18/9 are joined up with any potential disclosure remedies as a result of the forthcoming platform market study.

SCOPE OF CP18/9

1.9 Our understanding of the scope of the proposals in CP18/9 is that they apply to UK funds and not funds passported into the UK. We would welcome further clarity from the FCA on this point. Specifically, we believe that the final rules would need to be mindful of different disclosure requirements for overseas funds that are sold in the

UK and that some funds will need to ensure their KIIDs comply with regulatory standards in multiple EU jurisdictions.

1.10 Regarding the extension of the remedies in CP18/9 to unit-linked and with-profits business, we understand the FCA will make a final decision in H1 2019 following further work. Many unit linked funds either directly wrap authorised funds or mirror them. There is, therefore, an inherently close link between CP18/9 and the unit-linked universe, and changes in the fund universe will feed through. Regulators will need to take a view as to whether additional requirements are necessary for consistency of approach.

2. FUND OBJECTIVES GUIDANCE

FCA QUESTION 1: DO YOU AGREE WITH OUR DRAFT GUIDANCE ON FUND OBJECTIVES?

2.1 The IA supports the FCA's intentions that investors should benefit from improved clarity in how fund objectives, investment policy and strategy are described, including being better able to compare objectives between funds. It is in this spirit that the IA is undertaking further work with consumer representatives to identify and help promote the use of consistent terminology that is clear, succinct and easily comprehensible to consumers and their advisers. This work will be particularly relevant to the content of the KIIDs and fund factsheets and other consumer facing marketing material.

2.2 The IA agrees that KIIDs (and PRIIPs KIDs if and when they become relevant to authorised funds) should be written in a way that makes them accessible to retail investors. The IA also agrees that the KII Regulation specifically provides that the KIID shall include information about the essential features of a fund even if those features are not described in the prospectus.

INVESTMENT STRATEGY

2.3 Appendix 2, draft non-Handbook Guidance, paragraph 19 of CP18/9 states *"the FCA considers that it would generally be necessary for an adequate description of the objectives and investment policy to include relevant elements of the investment strategy"*. We believe this requires further clarification, given the distinctions between objective, policy and strategy:

2.3.1 The objective sets out what the fund aims to achieve (e.g. to provide capital growth over the medium to long-term by investing primarily in UK companies).

2.3.2 The investment policy sets out the broad parameters of the approach towards delivering the objective (e.g. the fund will primarily look to vary its exposure to UK companies within different sectors and across different sizes).

2.3.3 The strategy is the dynamic implementation of the policy and may react and adapt to changing market events within the broad framework set out in the policy (e.g. the fund currently has a small cap bias and has significant exposure to the UK financial sector).

2.4 The investment policy, as set out in the KIID, should describe the ways in which the manager is likely to deliver the objective, albeit at a higher level. We agree that investors should get essential information on the current investment strategy. However, these details are better placed in fund factsheets and marketing communications and not in the KIID. Indeed, the KII Regulation only permits the inclusion of key information on the investment strategy where this is *"necessary to adequately describe the objectives and investment policy of the UCITS"* (Article 7(4)). That detail may not always be required, depending on the strategy – sometimes the strategy is so close to the investment policy that there is little need for additional strategy information. Conversely, where the investment policy is more flexible, some key information on the long-term strategies may be necessary in understanding the objective and investment policy, e.g. for a bond fund, the investment grades of corporate bonds being targeted.

2.5 Unlike the prospectus and KIID, which are not straightforward to change, the flexibility that fund factsheets and other marketing communications provide is more conducive to the provision of information on how investment strategy changes over time. This can be helpful in telling investors the whole story about how strategy adapts to changing market conditions, where this is less evident from the investment policy. To better reflect this, we would suggest rewording paragraph 19 of the guidance as follows: *'[ ] the FCA encourages managers to consider the extent to which an adequate description of the objectives and investment policy may require inclusion of relevant elements of the investment strategy'.*

2.6 The materiality and speed of changes in the investment strategy should be considered. We would regard "relevant elements" as being material and long-term. Where a strategy involves shifts that are frequent but relatively small compared to the overall policy, periodic disclosure of these is likely to become quickly outdated and therefore not particularly helpful to investors in understanding what the fund is aiming to achieve.

2.7 As stated in paragraph 3.21 of CP18/9, the proposed guidance on fund objectives applies to key information documents and not to the prospectus. However, many IA member firms believe a review of how fund objectives are described in the prospectus will be required in order to meet the requirements, particularly given the expressed expectation that they disclose further details on the investment strategy. As such, this should be reflected in the Cost Benefit Analysis (CBA) which currently accounts for changes to the prospectus but only to mention and explain why benchmarks have been used.

EXPLAINING PORTFOLIO CONSTRAINTS

2.8 We support the policy intention of there being alignment between what an investor is told about the objective of a fund and the way in which that fund is being managed (i.e. how the portfolio is constructed). We recognise that one driver of this requirement has been a concern among regulators that some funds are suggesting an objective that in reality is not being delivered – or will not ever be delivered – by the underlying investment process in place. This should not be the experience of any investor in a well-functioning fund market.

2.9 The key question that then arises is how best to deliver that intention. As drafted, we have significant concerns that the proposals to explain the choice and use of any 'constraints' on a fund may prove unduly complex for investors, thus going against the principle of using simpler, consumer-friendly language.

2.10 The examples provided in CP18/9[2] as to what would constitute a constraint conflate three very different factors: imposed limits in portfolio construction, risk management processes, and remuneration policies. Our view is that a benchmark is relevant and should be disclosed to investors if there is a specific performance target in place (fully aligned with the FCA's 'target' definition) or if there is a set constraint on portfolio construction (partly aligned with the FCA's 'constraint' definition).

2.11 Moreover, as we outline in detail in section 3, pre-set portfolio constraints should be distinguished from cases such as the ability of the portfolio manager's governance structure (e.g. the investment committee) to temporarily restrict the portfolio for a period in view of prevailing market conditions – the latter should be viewed as part of the portfolio manager's active management process.

NON-FINANCIAL OBJECTIVES

2.12 Regarding non-financial objectives, including environmental, social and corporate governance objectives, we note that Appendix 2, paragraph 29 states that *"We [the FCA] expect, if a fund has such objectives, that it will set them out in its prospectus"*. It would be helpful if the FCA could clarify that, if there are cases where non-financial objectives are being followed by the fund manager but are not set out in the prospectus of an existing authorised fund, amendments to the prospectus to include such objectives will not be treated as fundamental or significant changes in accordance with COLL 4.3.

2.13 Moreover, there should be a distinction between what would relate to a product-specific approach, i.e. a fund that is being marketed on the basis of its non-financial objective (such as focus on green bonds[3] or a wider environmental and social label), and what would be a firm-level approach, e.g. a firm may have a research process that integrates the considerations of Environmental, Social and Governance (ESG) issues and a house policy on engaging with companies to which the firm has an exposure across all of its product set. We are of the view that only the former is of relevance to this CP as it bears direct relevance to how a fund is run and marketed to investors and specific expectations arise from it in terms of investment approach. However, this should not preclude any mention of the firm's house wide processes/policies in the investment policy/strategy (as per paragraph 2.4 above).

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[2] Paragraph 3.26, p.14.

[3] This touches upon what the High Level Expert Group report on sustainable finance has identified as Action 2: creating standards and label for green financial products.

3. BENCHMARK RULES

FCA QUESTION 2: DO YOU AGREE THAT WE SHOULD INTRODUCE A 'REQUIREMENT TO EXPLAIN' WITH REGARD TO AFMS' USE OF BENCHMARKS?

3.1 We are keen to work towards accessible, straightforward information to help investors understand how their money is being managed. The IA agrees with the proposals to include reference to benchmarks in all materials, where there is a stated benchmark. As we set out elsewhere in our response, (paragraph 3.15), we also recognise the value of comparators, as do our customers. If the intention is to introduce an additional level of granularity about why certain benchmarks have been selected as part of a portfolio management process, it would be useful for the FCA to provide examples as to how this would be most accessibly be explained in the consumer facing documents.

3.2 As Annex 2 paragraph 18 shows, investors may find it challenging when trying to interpret past performance. A disclosure rule requiring funds to show more than one benchmark, used for a range of different purposes by the fund, needs to be considered carefully to ensure it provides an accurate reflection of the portfolio construction of the fund. Showing multiple benchmarks may have adverse unintended consequences such as confusing or deterring clients from investing altogether, or revealing proprietary information. Initial results from the IA consumer testing suggests investors, including sophisticated investors, want simple, relevant representation of performance.

BENCHMARK DEFINITION

3.3 The draft rules introduce three different concepts for the way in which a fund will make use of benchmarks, namely a target, constraint and comparator. While the IA welcomes the FCA's attempt at providing clarity on the use of benchmarks, more clarity is needed around these three concepts.

3.4 Disclosing benchmarks should promote investor understanding as to how the portfolio will be managed to meet the stated objective. The way the proposed rules are drafted may not provide that for investors. There are two main reasons for this.

3.4.1 First, the concepts of target, constraint and comparator conflate benchmarks that influence the portfolio construction process (targets and constraints) with benchmarks used by fund managers and/or others on an ex post basis to assess performance (comparators). We recommend making a clearer distinction here. While it may be entirely appropriate for a manager to use comparators, this is a different process to the use of targets and constraints, with investors and their advisers likely also to have preferences.

3.4.2 Second, the definitions of all three concepts, and particularly that of 'constraining benchmark', are very broad. The proposed amendments to

COLL 4.2.5R, refers to arrangements according to which the portfolio is or '*is implied to be*' constrained by '*the value or price of an index or indices or any other similar factor*'.[4] This creates the potential both for inconsistent interpretation, and a degree of complexity, particularly in the light of the requirements in COLL 4.5.2 to explain the '*choice and use*' of every target, constraint and comparator.

3.5 As we set out in more detail in 3.10-3.12, we encourage the FCA to reconsider the way these requirements are framed, to reflect the central purpose of the proposed rules, which is to capture those funds that are closely managed, on a permanent basis, by reference to a benchmark or where there are strict limits on portfolio construction imposed on the manager.

Target benchmark

3.6 We agree that where there is a target benchmark (i.e. the investment objective states that the fund aims to outperform a benchmark), this should be clearly disclosed in communication materials and that performance should be reported against the target.

Constraining benchmark

3.7 A hard-coded limit set on the portfolio construction that will require action if exceeded is indeed a portfolio constraint that should be disclosed to investors. Examples of this would include:

- Where the portfolio of the fund is managed with reference to an index, for example, a fund invests primarily (at least 70%) in shares included in the FTSE All Share Index, but will ordinarily have fewer than 80 holdings.

- Managing the fund so that its tracking error from a set index never exceeds a specific percentage.

3.8 In contrast, there are numerous examples where there are constraints that do not act as benchmarks:

- References to an index as part of risk management processes that only aim to flag specific situations (and, indeed, risks). These are a choice and do not require any immediate action and, as such, are not a constraining benchmark.

- Circumstances where an investment manager is temporarily restricted on portfolio investments, for example by an investment committee's choice in reaction to market conditions, which we would view as part of the investment process.[5]

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[4] Annex C of the draft Instrument in CP18/9.

[5] The investment activities of the individual portfolio manager will usually be overseen by the portfolio management firm's investment committee (or asset class specific investment committees), which may from time to time impose limits on the individual investment decisions of the portfolio manager that,

- Circumstances where a portfolio manager may start with a large index (in terms of numbers of stocks and securities and/or breadth of geography), but restrict selection to a much small number of stocks and securities, or a sub set of countries within a global index. In practise, the portfolio is not being managed against the index, and it does not act as a constraining benchmark.

- Where fixed income funds have a duration constraint, intended to deliver returns within these constraints, we would view this as a broader portfolio constraint that should be disclosed. It is not a constraining benchmark.

3.9 CP18/9 paragraph 3.26 also describes fund manager remuneration as an example of a portfolio constraint. Typically, variable remuneration is based on multiple factors, only one of which might involve performance with reference to a specific benchmark. Moreover, to the extent to which performance with reference to a specific benchmark is a factor in the overall remuneration of a fund manager, performance is likely to be judged across multiple funds and other investment mandates managed by the individuals, rather than any single fund. In addition, this use of a benchmark as one of the factors to determine remuneration should not automatically be considered a constraint – in many cases it does not restrict the portfolio manager's freedom to construct and manage the portfolio independent of the benchmark. We would expect fund managers' remuneration to align with the best interests of both the fund and investors.

3.10 Consideration therefore needs to be given to what is a true constraining benchmark. Specifically, the final rules need to distinguish between constraints imposed on the manager of the fund through the fund rules (e.g. the prospectus, investment mandate) that will require specific action should predetermined thresholds be exceeded, and active investment decisions that are taken by the manager or the investment committee.

3.11 We propose, therefore, that in place of a requirement to explain the choice and use of any constraining benchmark on a fund, the requirement should be made more straightforward and refer to those benchmarks that are most relevant. COBS 4.5.12 should simply stipulate that where there is a target or constraint on the fund relating to a benchmark, information should be provided about the use of that benchmark.

3.12 We propose also that the language in COBS 4.2.5 is revisited to address the ambiguity around 'implied' constraints and 'similar factors'. Again, we suggest a more straightforward approach to capture circumstances in which a target is set or specific constraints are placed on the construction of a portfolio by reference to the value, price or components of an index.

Comparator benchmarks

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whilst at all times consistent with the investment objective and policy of the relevant fund, reflect the investment committee's views of the prevailing market conditions. The imposition of such limits should be viewed as part of the active investment process, not as a constraint inherent in the fund mandate.

3.13 We see comparator benchmarks as different in nature. Targets and constraints are entirely within the control of the fund manager, and have a bearing on the portfolio management process. Comparators play a much wider role and are not necessarily within the control of the manager: investors and their advisers may adopt a wide range of comparators, regardless of what a manager may use. Initial IA customer research suggests that savers may have very specific views on appropriate comparators.

3.14 This is not to argue against the use of comparators in fund communications. Initial IA customer research suggests that investors expect comparators. Rather, the communication needs to be clear about the role of a comparator benchmark. It may be appropriate to simplify the requirements regarding comparators such that there is a statement as to how investors may wish to assess the performance of the scheme. This could take the form of additional comparators where there is a stated benchmark (target or constraint), or comparators where there is no stated benchmark (target or constraint).

FCA QUESTION 3: DO YOU AGREE THAT WE SHOULD INTRODUCE RULES AND GUIDANCE TO REQUIRE CONSISTENCY IN REFERENCES TO BENCHMARKS ACROSS THE SAME FUND'S DOCUMENTATION?

3.15 The IA agrees that where benchmarks are referenced, they should be referenced consistently across the same fund's documentation. However, these rules should not preclude the ability to tailor the documentation to an investor's specific requirements and as above, there may be circumstances where referring to a different comparator would be useful.

3.16 Explaining complex benchmarks (e.g. composite benchmarks) and constraints in all communications may cause problems where these disclosures are lengthy but the actual document is subject to space constraints, as is the case for the KIID. It is not clear from the proposed rules whether the full disclosure is necessary in every relevant communication.

3.17 In paragraph 3.32 the FCA states that where some fund managers present their funds' past performance against different benchmarks in different consumer documents, this could confuse investors. However, paragraph 3.36 of the CP states that the use of different comparator benchmarks for different clients may be appropriate and in the clients' best interests, in the course of interactive dialogue with the client. We believe that, if described correctly, showing past performance against different benchmarks in different consumer documents could provide valuable insights to different groups of investors (retail versus institutional for example) in accordance with their particular requirements.

WHERE THERE IS NO BENCHMARK

3.18 The proposed rules require that where there is no benchmark, the AFM explains in the prospectus and relevant communications how investors should assess the fund's performance. Three key issues arise from this:

3.18.1 First, where firms try to explain to investors how to assess the fund's performance, a comparator benchmark could be created even where having one may not be appropriate. Due to the rules requiring comparative benchmarks to be communicated, the spill-over effect means a benchmark has therefore been created and must be communicated and included in all materials.

3.18.2 Second, and equally important, if no benchmark is used and AFMs are required to refer to one for investors to assess performance, there is a risk that this would result in the AFM needing to obtain and pay for a licence for that benchmark. This in turn may mean that the fund has to bear an additional cost. The final rules should make clear that no such reference is expected in this situation and/or the CBA amended accordingly to reflect any additional costs arising from this.

3.18.3 Third, for some funds without a benchmark, for example unfettered risk profile funds, identification of an appropriate benchmark could prove difficult and may need to be changed on a regular basis to remain reflective of the necessary ongoing changes to asset allocation.

3.19 Where there is no benchmark, firms should be able to suggest that investors choose their own method for how to assess the fund's performance, or suggest possible comparators, such as 'outperforming cash'.

3.20 Importantly, any rule changes will need to be mindful of potential unintended consequences whereby funds that do not have a benchmark could come to be viewed with scepticism or considered to be substandard.

3.21 Considering these points, the IA would welcome further guidance from the FCA on how it envisages this working in practice and provide examples.

3.22 Finally, while all non-structured UCITS are automatically non-complex, there is a need to avoid impacting the complex/non-complex assessment of funds under MiFID II, given the final criteria of the test (MiFID II Delegated Regulation Article 57(f) as transposed into COBS 10.4(3)(c) requires, inter alia, the information to be "likely to be readily understood so as to enable the average retail client to make an informed judgement as to whether to enter in to a transaction in that instrument".

FCA QUESTION 4: 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?

3.23 The IA agrees that, where a benchmark is identified in a fund's objective and policy (as either an explicit target or form of constraint), it should be displayed against that fund's past performance where that past performance is shown. However, as per our comments on the approach to targets and constraints, we do not agree that an AFM should automatically show past performance against all constraints and targets. A judgement has to be made about how to display the most relevant information without overloading disclosure materials. Behavioural research shows that if there is too much information and too many options, consumers are discouraged from investing altogether. But more importantly, it may be that some of these benchmarks do not make for a meaningful comparison and could thus mislead investors if too much emphasis is placed upon them.

3.24 There are also practical limitations arising from the requirements of regulatory documents. While the UCITS KIID Regulation requires benchmarks to be stated when used, and performance to be displayed against such benchmarks, the format of the past performance section of the UCITS KIID is not suitable for all benchmark types, for example, where the fund objective involves volatility and capital preservation. Another potential limitation is where firms reference benchmarks as an income yield target in some objectives; the past performance of that benchmark has to be shown on the KIID but the fund is only referencing the benchmark for income yield targeting, not for overall fund performance.

3.25 Instead of showing past performance against multiple constraining and target benchmarks, the IA therefore recommends that firms could use only one benchmark in the consumer facing documentation when displaying the fund's past performance. The benchmark used should be the one the manager deems most appropriate. The manager should, on request, be able and willing to justify to investors and the regulator why this benchmark has been chosen, and report performance (and any performance fees) against it, rather than any other benchmark. In any case, KII Regulation 583/2010, Article 7(1)(d) and Article 18(1) implies that only one benchmark is to be used. In this context, it should be highlighted that the most appropriate benchmark may not necessarily be the one with the most challenging performance threshold. However, where firms may consider it useful and beneficial to investors to show multiple benchmarks, the rules should allow them the flexibility to do so.

4. OTHER CONSIDERATIONS

IMPLEMENTATION TIMEFRAME – PROPOSED BENCHMARK RULES

4.1 For the proposed benchmark rules, the CP proposes an implementation period of three months for new funds and six months for existing funds.

4.2 A six month implementation period for the proposed rules on benchmarks, particularly for existing funds, is too short, when taking into consideration the task of reviewing all documentation across all funds, as well as how long distributors may need to reflect all the changes. Firms will have to amend and re-issue written documentation for all funds as a result of the proposed benchmark rules. It is also too short an implementation period for firms who need to go through the process of identifying whether use of a benchmark is implied according to the criteria set by the FCA and should therefore be disclosed. This is particularly the case for firms with a large number of funds.

4.3 The IA proposes that implementation for existing funds should be by February 2020.

4.3.1 It will allow firms time to understand the rules on benchmarks and implement the necessary changes properly, taking into consideration the need to review the documentation in light of the guidance. This would particularly help address short implementation deadlines for funds whose annual review will coincide with the introduction of these rules.

4.3.2 It will allow the KIID, which is currently under review for amendments in line with PRIIPs, to be on the same timeframe.

4.3.3 Some changes may need to be replicated in feeder funds in other jurisdictions where policy changes have a very long lead-time.

4.4 The feasibility of this proposed timing depends on the final rules being published before the end of 2018.

4.5 Regarding the three month implementation period for new funds to comply with the benchmark rules, we understand the aim is to avoid authorisation delays to funds already in or close to the application process. Clarity from the FCA to confirm this in the final rules would be welcome.

IMPLEMENTATION TIMEFRAME – FUND OBJECTIVE GUIDANCE

4.6 The fund objectives guidance will presumably be applicable from the day of publication. The scale of change is such that it would be helpful to have some clarity on how the FCA would expect firms to comply with the guidance when it goes beyond the current rules. In addition to the documentation review for proposed rules on benchmarks, firms will also have to review all written documentation to reflect the proposed fund objectives guidance. Significant amounts of materials would need updating, often with reliance on external parties for data provision and outsourced documentation creation arrangement.[6] An additional consideration is how quickly distributors can process the changes.

4.7 It should be noted that the rules on showing past performance in the UCITS KIID may only be applicable for a short period of time before the PRIIPs KID is scheduled to become mandatory for UCITS and NURS as the PRIIPs KID has no comparable past performance section. We would welcome further clarity from the FCA on its expectations regarding the implementation of these rules and guidance once performance disclosure moves to performance scenarios.

COST BENEFIT ANALYSIS

4.8 The CBA, Annex 2, paragraph 22 states that the FCA expects the one-off costs to AFMs for the proposed rules (excluding the fund objective clarifications), to be small, but not negligible. While the industry is highly supportive of the direction of travel, we suggest that the CBA understates the costs, which include:

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[6] A review will encompass a number of stakeholders in each firm (product managers, legal, compliance, risk, portfolio managers, marketing, communications, as well as, in many cases, external consultants and/or legal advisers). Final approval then comes through the firm's governance processes, e.g. product governance committees, risk and compliance committees, and ultimately the Board.

4.8.1 Obtaining licences to use benchmarks have risen substantially over recent years (members report examples of a 400% increase in licencing fees).

4.8.2 The time and administrative effort of switching (as may be necessary in some cases) from one index to another as a benchmark.

4.8.3 Depositary submission and literature changes after the analysis and disclosure descriptions.

4.8.4 Consumer testing of the new disclosures for effectiveness.

4.8.5 Investor notification mailing requirements, updates to data vendors' systems and platform notifications.

4.9 In one firm's view, a conservative estimate of the actual costs of both the proposed guidance and rule changes could be circa £0.5m per firm and this relates only to implementation rather than ongoing costs.

OVERLAP WITH THE EU BENCHMARK REGULATION

4.10 Where the scope of CP18/9 overlaps with the EU Benchmark Regulation (BMR), firms will only be able to use benchmarks on the ESMA Register. However, as comparison is not in scope of the BMR, benchmarks used for this purpose need not be on the ESMA Register. This could open up firms and investors to the risks that the BMR was designed to prevent, i.e. the use of unregulated benchmarks potentially open to manipulation. Firms will have to consider the risks before using such a benchmark as a comparator.

4.11 Please see the attached Annex for a comparison between the EU Benchmark Regulation and FCA proposals on benchmarks.

MATERIALITY OF CHANGE

4.12 The IA believes greater clarity is needed as to what would constitute a material change. The proposed rules and guidance require a judgement to be made in a number of areas which could lead to frequent changes to the KIID/KID, for minimal information, leading to necessary expense and confusion.

4.13 For example, what materiality should be applied in the on-going assessment in the following example scenarios:

- Change of outperformance target by X% – is this a material change to the risk profile of the scheme?
- Change of tracking error target range by X – what level of change to tracking error target becomes a significant, fundamental notifiable change?

4.14 Where changes are made to the prospectus as a result of reviewing all documentation and that change is significant or fundamental, FCA authorisation will be required. It is not clear whether the change to the strategy of the portfolio necessitating the change to the documentation should happen first or vice versa.

5. PERFORMANCE FEES

FCA QUESTION 5: DO YOU AGREE THAT WE SHOULD REMOVE THE POSSIBILITY THAT PERFORMANCE FEES COULD BE TAKEN ON GROSS PERFORMANCE?

5.1 The IA agrees with the proposal to move from guidance to a rule to prevent AFMs from charging performance fees based on gross performance.

5.2 We are not aware of any firm charging performance fees based on gross performance for authorised funds.

ANNEX: BENCHMARKS – BMR AND FCA PROPOSALS IN CP18/9

Scope				
BMR		**FCA**		**Mismatch**
L1 text	**ESMA Q&A**			
Tracking the return of an index	Investment funds the strategy of which is to replicate or track the performance of an index or indices e.g. through synthetic or physical replication; and	**Constraint**	An index or similar factor used by AFMs as a constraint on a fund's portfolio construction. Example: • a UK equity fund whose portfolio will differ from the composition of an index (such as the FTSE-100) by no more than a set amount (a partly active fund); • the risk management process for a fund causing it to be monitored and controlled relative to a benchmark; • the individuals managing the fund being remunerated based on its performance relative to a benchmark; • the portfolio management system restricting transactions using hard or soft limits relative to a benchmark Cf FCA CP18-9 3.26 Firms should assess whether the last 3 restrictions mean the fund is, in practice, managed with reference to a benchmark.	FCA require all benchmarks used to be shown in any past performance
	Structured investment funds that provide investors with algorithm-based payoffs that are linked to the performance, or to the realisation of price changes or other conditions, of indices. ESMA Q&A 5.3			FCA scope is broader, as it includes 'similar factor'
Defining the **asset allocation** of a portfolio	An index used to measure the performance of an investment fund with the purpose of defining its asset allocation when the documentation, and in particular its investment policy or investment strategy, define constraints on the asset allocation of the portfolio in relation to an index. For example the investment policy or strategy may require the investment fund to invest a percentage or the whole portfolio in securities ESMA Q&A 5.4 that are constituents of an index. Investment funds using indices to measure their performance with the purpose of defining the asset allocation thus may include investment funds that are actively managed (where the manager has discretion over the composition of its portfolio subject to the investment objectives and strategies as opposed to a fund that tracks the return of the index).			Constraints covers both Tracking and Defining the asset allocation; but also: • Risk management • Individual remuneration etc.

Computing the **performance fees**		**Target**	An index or similar factor that is part of a target an AFM has set for a fund's performance to match or exceed, which necessarily includes anything used for performance fee calculation: A target for a scheme's performance, or a threshold for payment out of scheme property to be permitted, by reference to a comparison of one or more aspects of the scheme property or price with fluctuations in the value or price of an index or indices or any other similar factor. For example: • to 'outperform LIBOR + 4%'; • 'achieve a return >6% per year'; • 'track the return of the FTSE-100'; • 'beat the FTSE All-share'; or • targeting a level of income for the fund	FCA require all benchmarks used to be shown in any past performance
				Targets non-performance fee issues, more akin to 'objective' or 'aim'.
Comparing performance is *not* in scope	Indices referenced in the documentation of an investment fund solely to compare the performance of the investment fund, where no investment constraint on the asset allocation of the portfolio is established in relation to the index. ESMA Q&A 5.5	**Comparator**	An index or similar factor to which an AFM compares a fund's performance, such as 'the return of the FTSE All-share'.	FCA scope is broader, as it includes 'similar factor'
No use of benchmarks in scope	No obligations	None of above used	AFM must provide a statement to that effect and an explanation of how investors can assess the performance of the scheme.	