

THE
INVESTMENT
ASSOCIATION

FUND MANAGEMENT AND OVERSIGHT

Introduction to the ACD Model

June 2021



ABOUT THE IA

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad.

Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. IA members hold in total over one third (36%) of the value of UK publicly listed companies. We use this collective voice to influence company behaviour and hold businesses to account.

PURPOSE OF PAPER

THE UK – AND EUROPEAN – FUND DELIVERY MODEL CAN SOMETIMES SEEM COMPLEX. IT IS IN FACT DESIGNED TO ENSURE CLEARLY DELINEATED ROLES, WITH CHECKS AND BALANCES TO MAINTAIN AN INVESTOR FOCUS AND STRONG LEVELS OF INVESTOR PROTECTION.

This paper explains the role of the independent Authorised Corporate Director (ACD) in the context of the current wider focus on culture and governance across the fund management industry. It is in three parts:

- Part One sets out what an ACD does, alongside other key institutions involved in fund delivery, notably the depositary and investment manager.
- Part Two describes the different operating models.
- Part Three gives an overview of governance matters and operating responsibilities.

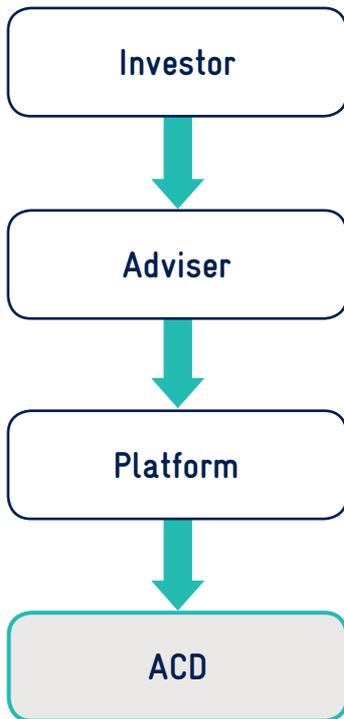


I. SETTING THE SCENE

At the heart of the UK fund governance model sit two key institutions:

- The Authorised Corporate Director (ACD), which is there to manage the fund on a day-to-day basis; and
- The Depositary, which provides oversight of the ACD's activities and therefore must be independent of it.

UK investors can invest directly with the ACD or via an intermediary, usually a platform and may also take advice from a professional adviser. It is becoming less common in the UK for investors, particularly individuals, to invest directly with the ACD. It is important that information on the fund is passed through the chain from the ACD to the investor and that relevant information about the investor that may help the ACD manage the fund is received by the ACD.



WHAT IS AN AUTHORISED CORPORATE DIRECTOR?

An Authorised Fund Manager (AFM), Authorised Corporate Director (ACD) and Operator perform the same role for different fund types.¹ An AFM manages an authorised unit trust, an Operator manages an authorised contractual scheme (ACS) and the ACD performs the same role for an Open-Ended Investment Company (OEIC). **The ACD is legally responsible for the day-to-day management of the fund and must ensure that the fund is managed within the applicable regulations.**

WHAT IS A DEPOSITARY?

UK authorised funds must appoint either a Trustee, in the case of a unit trust or Depositary, in the case of an OEIC or ACS. **The Depositary is independent from the ACD and has an important role in investor protection and is responsible for the safekeeping of a fund's assets, holding them separately from those of the ACD, in case the ACD becomes insolvent.**

In practice, most UK Depositaries delegate the safekeeping of assets to a custodian, which is often a specialist part of a large bank, although it is an independent entity, with its business separated from the rest of the bank.

The Depositary must oversee the custodian and ensure that they hold the assets correctly in line with the rules. The Depositary also has oversight responsibilities of the ACD's operations, ensuring the fund's investments are in line with the rules and the fund's investment objective, that the fund is valued correctly and that the ACD has proper procedures to correctly process the buying and selling of units/shares by investors. The Depositary also monitors the fund's cash flows².

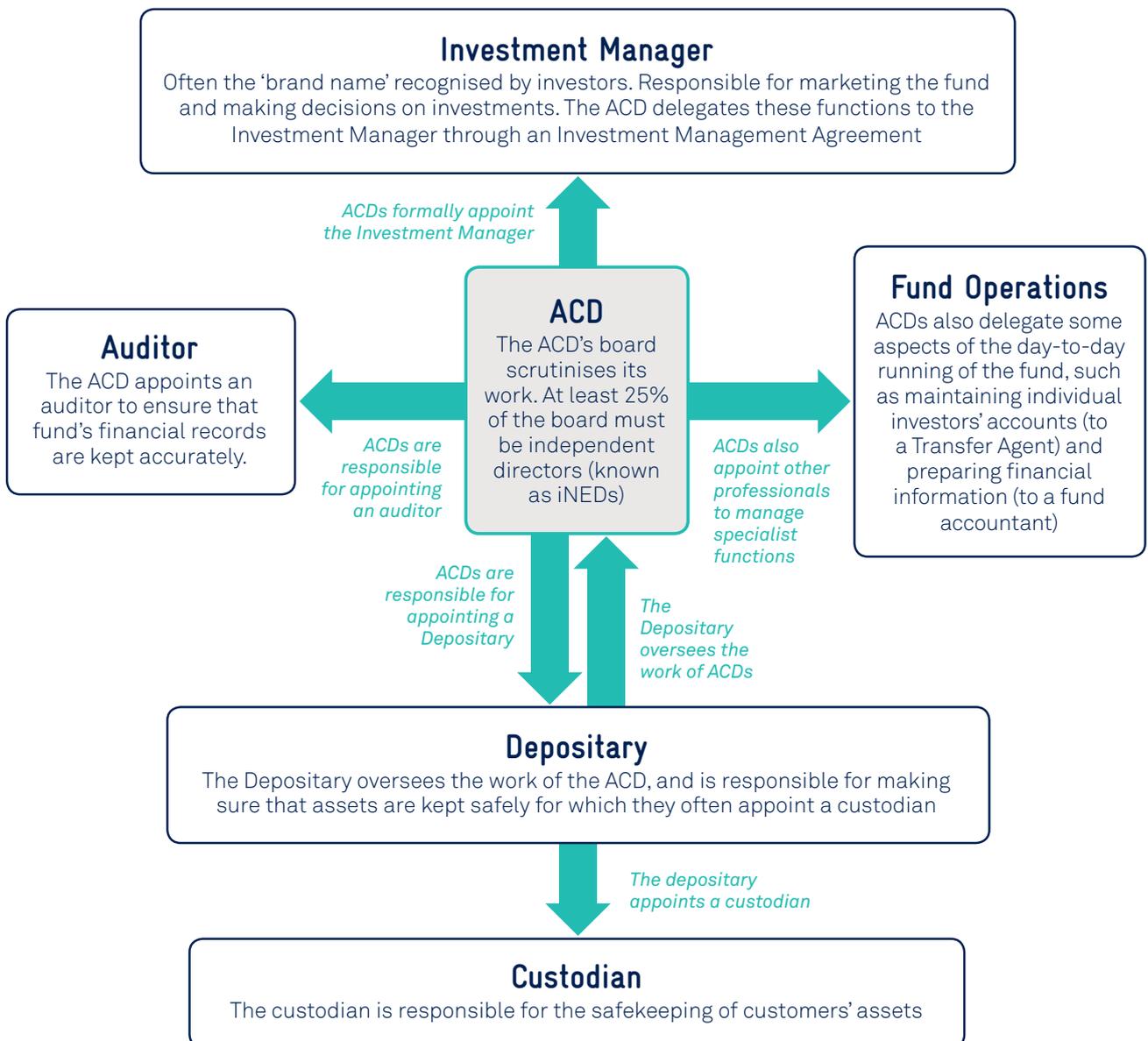
¹ The FCA uses the term "AFM" to cover all types of entity, but as the most common type of authorised fund in the UK is an OEIC, we will use the term ACD.

² The requirement for the Depositary to be structurally independent of the ACD means it cannot be part of the same corporate group as the ACD. This is a higher standard than in most EU countries, which only require the Depositary to be functionally independent, meaning they can be part of the same group as the ACD, but must have different management and supervisory boards.

INVESTMENT MANAGEMENT

It is usual for the day-to-day investment management of a fund to be delegated by the ACD to a regulated investment manager. Sometimes referred to as the investment or portfolio adviser to the fund, the investment manager is the professional making the decisions to buy or sell specific financial instruments such as shares or bonds in order to achieve the fund's investment objectives.

The investment manager may be part of the same group of firms as the ACD, or the ACD may appoint a firm who has no other legal relationship with it. The ACD must ensure that the investment manager invests the fund's assets in line with the objectives, strategy and investment principles of the fund and the applicable regulations. It is important to note that, even if the ACD delegates investment management, the FCA still regard the ACD, rather than the investment manager, as being responsible for how the fund is managed.



INVESTOR PROTECTION

The ultimate responsibility of all parties is to protect investors. There are a range of measures that firms take to do this:

- **All parties are bound by regulation to “act honestly, fairly and professionally in accordance with the best interests of its client”.**
- **The Depositary must act solely in the interests of investors.** In this regard, it will oversee the ACD’s activities to ensure that they are performed in accordance with regulation and in investors’ best interests.
- **The ACD Board will oversee the ACD’s operations** and ensure the fund provides value to investors.
- **Senior managers must follow a strict code of conduct** and can be held personally liable for any failings.
- **The assets of a fund and investors’ uninvested cash must be held separately** from the assets of the ACD and other parties, to protect them in the event of the insolvency of any of those parties.
- **Investors must be given fair and reliable information about investment products.** In any communication with investors or potential investors, firms must regard investors’ information needs and communicate information with them in a way that is clear, fair and not misleading. This principle is strengthened by detailed rules on the information that must be contained in various regulatory documents.
- **ACDs can employ pricing mechanisms and liquidity tools to ensure that all investors are treated fairly.** This includes adjusting the price of a redemption deal to reflect the costs of disposing of assets and suspending investor dealing in a fund where assets would have to be sold at an unusually low price to raise money to fund those redemptions.
- **If any of the parties make an error that leads to investor loss, they will ensure that investors are compensated** for such loss.
- **If there is a dispute between the investor and the ACD that cannot be settled between them, the case can be adjudicated by an independent body,** the Financial Ombudsman.



II. ACD OPERATING MODELS

The ACD is ultimately responsible for the day-to-day management of an authorised fund and ensuring that the fund is managed within legal, regulatory and fund-specific parameters. An ACD can delegate many of its functions, although it must employ satisfactory oversight procedures to ensure that all delegates are performing their functions to a competent standard. Importantly, the ACD cannot delegate all of its functions such that it becomes a “letter box” and it will normally retain the risk function.

The ACD normally assumes one of three models:

- The “internal ACD” model, where the ACD of the fund is part of the same corporate group as the firm performing investment management. In practice, the activities are formally separated between the ACD and the investment management company.
- The “independent (or host) ACD” model. With this model, an independent ACD will be from outside the corporate group to which the investment manager belongs.
- Those ACDs who are also the sponsors or promoters of the fund, but outsource the investment management. This model is relatively uncommon and, as such, we will not focus on this.

DIFFERENT ACD MODELS

Internal model

Wigan Funds acts as the ACD; **Wigan Asset Management** provides investment services to the fund(s) through the terms of an Investment Management Agreement (IMA). Both firms are part of a group called **Wigan Investments Ltd**. In this model, **Chorley Depository** is appointed by the ACD through a Depository Agreement and is independent of Wigan Investments Ltd.

Independent model

Wigan Investments Ltd wants to establish a fund. They choose **Preston Funds** as the independent ACD, and **Wigan Asset Management** is formally appointed by Preston Funds as investment manager through an Investment Management Agreement (IMA). If appropriate, there may also be a Distribution Agreement in place between the two parties. Preston Funds appoints **Chorley Depository** as independent depository through a Depository Agreement entered into by Preston Funds, Chorley and the fund.

The appointment of Preston Funds by Wigan Investments Ltd will usually be formalised by a Sponsorship Agreement, which Wigan Investments Ltd will be able to terminate with a period of notice if it decides it wants to replace Preston Funds as ACD. The Sponsorship Agreement will also contain a provision for Preston Funds to terminate with a period of notice if it wishes to step down as ACD or if it concludes that Wigan Investments Ltd are not complying with their regulatory or other obligations. The IMA will also contain provisions to allow Preston Funds to replace Wigan Asset Management if it considers that it will be in the best interests of the investors.



III. GOVERNANCE AND WIDER RESPONSIBILITIES

Regardless of whether independent or internal, the ACD must employ a strong governance model, with a governing body, e.g. board of directors overseeing its activities and providing challenge, where necessary.

GOVERNANCE STRUCTURE

In all models, at least one quarter of the members of the governing body (or two people, where there are fewer than eight people) must be independent of the ACD. These independent members of the governing body must possess sufficient expertise and experience to be able to judge whether the ACD is managing the fund(s) in the best interests of investors. Members of the governing body are likely to be performing FCA-designated senior management functions under the Senior Management & Certification Regime (SMCR) and are subject to robust regulatory requirements that ensure that governance of the ACD is strengthened. It will also be common for one of the independent members of the governing body to act as Chair of the governing body and its Risk Committee.

Under SMCR, relevant staff must be trained on the conduct rules and how they apply to their roles. Staff in certified roles must be deemed fit and proper to perform that role by their firms. The conduct rules outline that relevant people must:

1. Act with integrity
2. Act with due care, skill and diligence
3. Be open and cooperative with the FCA
4. Pay due regard to the interests of customers and treat them fairly
5. Observe proper standards of market conduct

KEY AREAS OF ACD ROLE

The ACD's role can be broken down into the following key areas:

Overall governance and operational oversight

- Ensuring the fund is managed to its mandate and is distributed through agreed channels to a specified audience (the target market).
- Arranges the appointment of fit and proper persons to perform any delegated functions. These functions may include investment management, fund administration, fund accounting and marketing.
- Ensures that any delegated functions are governed properly by legal agreements and documentation and are performed properly and within the applicable regulations.

Risk management

- Ensures that the risks inherent in the fund and within the ACD, including operational and liquidity risk, are monitored and managed effectively. 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 risks³.

Value assessment

- Produces an annual assessment of value, which looks at whether a fund provides good value for investors. If this is found not to be the case, the ACD needs to come up with a plan to make it better value for investors. The Chair of the governing body has a prescribed responsibility for the value assessment.

³ There is an exception for this for firms that are too small to have separate investment and risk teams, but they must still ensure that risks are properly monitored and managed.

Investor disclosure

- Produces regulatory documentation, such as Prospectus and KIID, which tells investors the features of the fund. The marketing material may be produced by the sponsor or distributor.
- 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 that have been bought and sold. The report, which is produced in accordance with international accounting standards, 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 annual report is audited by a fully independent auditor.

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 been 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.
- 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.
- Makes sure that investors have the facility to buy and sell units/shares in the fund and that their details are correct and up to date. Although this service is often outsourced to another company (the Transfer Agent), the ACD maintains responsibility and must therefore ensure that the company is performing its tasks accurately.

- 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. Again, this function is often outsourced to another company (the Fund Accountant), but the ACD maintains responsibility and must therefore oversee their processes.
- Arrange to pay any fees and charges from the funds (subject to approval by the independent depositary).
- Makes sure that the fund adheres to laws and regulations to combat money laundering and the financing of terrorism applicable to the United Kingdom.
- Makes sure that the identity of the fund's investors is established, in accordance with FATF requirements.

Other duties

- Identifies, monitors and manages any conflicts of interest arising from the fund and its management.
- Appoints and liaises with the depositary.
- Reports breaches in relation to the fund to the depositary, and, in more serious cases, the FCA.
- Liaises with the FCA on matters relating to the ACD and the fund.

OBLIGATIONS AND MANAGEMENT OF CONFLICTS OF INTEREST

It is important to emphasise that ACDs can face challenges and conflicts, whichever model is used, but the nature of these clearly differs, depending on whether the ACD is independent or internal. As such, the essential point is how those challenges and conflicts are managed, as in any set of business relationships. This conflict management is currently the subject of significant attention by firms and the UK regulator, with structural changes underway – notably, the wider incorporation of independent non-executive directors (INEDs) – and a growing focus on broader culture.

Oversight of delegated functions is a critical element and needs to be carefully coordinated. Effective oversight can become more difficult the larger the number of delegate relationships there are. This may be more pertinent for independent ACDs, who will have a number of investment managers to deal with, compared to an in-house ACD who will have only one. That is why the FCA would expect an independent ACD to be resourced accordingly.

INVESTMENT MANAGEMENT AND THE INDEPENDENT ACD MODEL

The relationship with a delegate must be at “arm’s length”, i.e. it must be an independent relationship. For independent ACDs, this is structurally the case, given that the ACD legally appoints the investment manager. As part of this process, the ACD will have the right to terminate the agreement with reasonable notice and the ACD will have further powers to remove the investment manager with immediate effect, where it believes that the investment manager is in breach of its obligations or is not acting in the best interests of the fund and its investors.

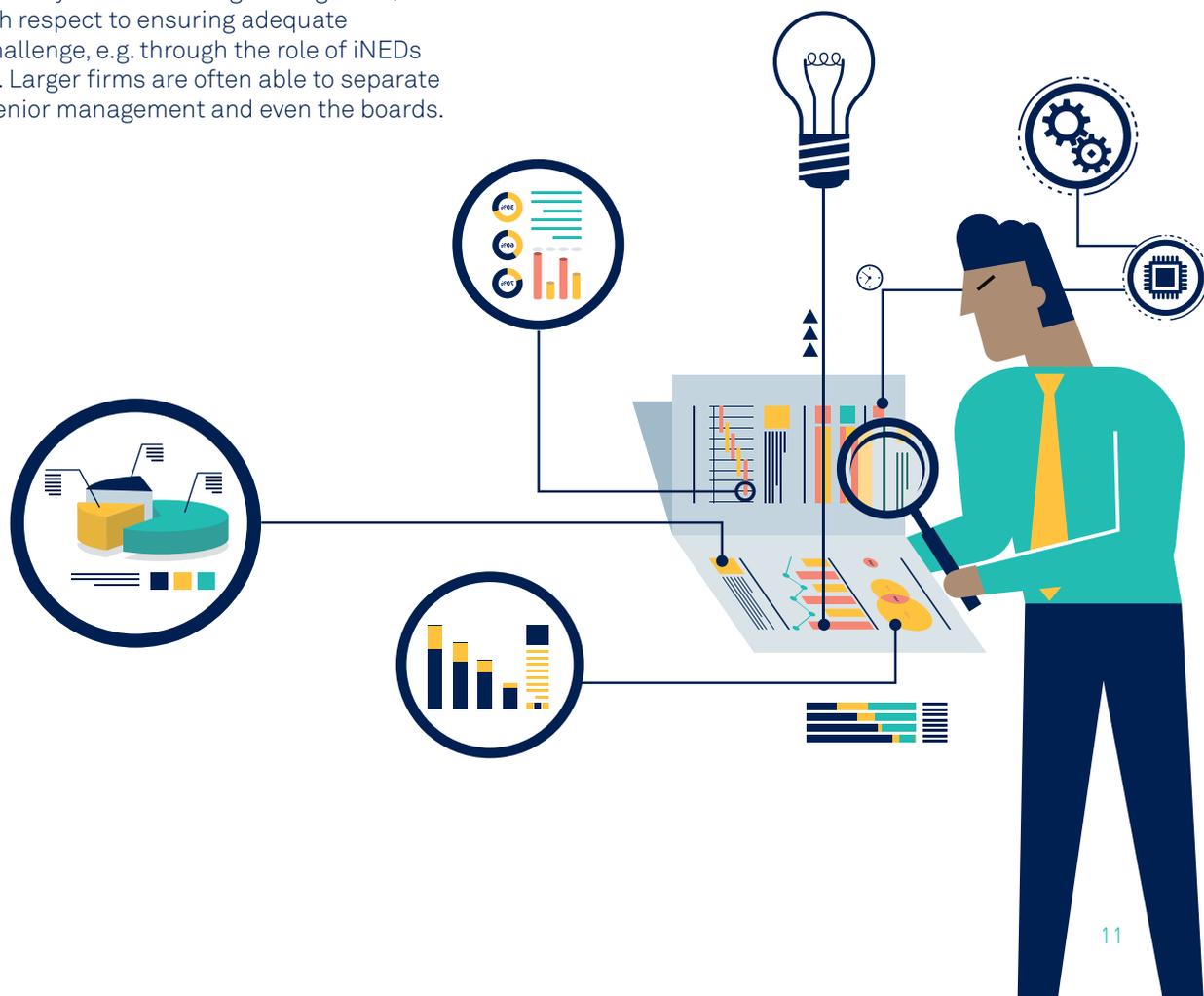
At the same time, the independent ACD also has to manage the commercial realities of this process. The investment manager will be the firm that initiates the idea for the fund and will have the investor base and will thus select the ACD. In this case, the investment manager has the ability to remove the ACD and request that it transfers the fund to a new ACD of its choice. This has the potential to create the conditions for undue influence over the ACD by the investment manager. However, the ACD retains the ultimate responsibility to act in the best interests of investors.⁴ Furthermore, any change of ACD must be approved by the fund’s depositary, as well as the FCA. In addition, the retiring ACD is obliged to ensure that the new ACD is suitably regulated and therefore qualified to manage the fund.

⁴ For UK UCITS funds, this is embodied in the FCA rulebook in Coll 6.6A 2R(6), which states that a fund management company must, in carrying out its functions, “act honestly, fairly, professionally and independently; and solely in the interests of the UK UCITS scheme and its unit/shareholders.” MiFID and MiFID II impose equivalent obligations on investment managers.

CONFLICT MANAGEMENT IN THE INTERNAL ACD MODEL

Internal ACDs share the same requirement for an independent relationship with delegates. For funds with the ACD and investment manager in the same group, the ACD business may not be functionally independent from the investment management business, particularly in smaller firms. It may share an ultimate governing body, senior management, independent functions such as Compliance or Risk, data and/or operating premises. The internal ACD often also has a lower profile commercially relative to the investment management business.

The ACD therefore needs to ensure that it can perform an independent review of the investment manager. The investment management business must similarly be confident that the ACD is performing its functions to a sufficient standard. As part of this process, the group will, as far as possible, separate the ACD business from the investment management business, with first line staff working for one, rather than both areas. Many firms have been looking again at their governance structures in recent years and strengthening them, particularly with respect to ensuring adequate independent challenge, e.g. through the role of iNEDs on fund boards. Larger firms are often able to separate the business' senior management and even the boards.





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