THE
INVESTMENT
ASSOCIATION

The Investment Association

MEMBER GUIDANCE

IA GUIDANCE AND FAQS ON VALUE ASSESSMENT AND REPORTING REQUIREMENTS FOR UK AUTHORISED FUND MANAGERS

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INTRODUCTION

Following the final report of the asset management market study (AMMS)[1], the FCA introduced (among other reforms) new rules on fund governance aiming to strengthen the pre-existing duty of care and acting in investors' best interest rules[2]. These are outlined in the FCA policy statement PS18/8[3] and came into effect on 30 September 2019.

These rules have moved the industry to a place where the governing body of an Authorised Fund Manager (AFM) or a UCITS management company authorised in the UK by the FCA (for the purposes of simplicity, "AFM" will be used for both types of firm in this document) must perform a detailed assessment on whether the fees paid by investors in its funds are justified by the value delivered by the funds to investors. Those firms are then required to publish an annual statement summarising the outcome of this process. AFMs must use a specific set of criteria for this assessment which the FCA has aligned closely with the Gartenberg factors in the US model. For schemes that are within scope, AFMs are required to carry out this assessment and publish the statement within four months of the accounting period end or, if they elect to publish a composite report covering two or more funds, within four months of the reference date chosen for the value assessment for those funds.

The process through which AFMs carry out this assessment is subject to internal scrutiny by the

[1] FCA Asset Management Market Study https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf
[2] The best interests rules are set out in Annex 1.
[3] FCA Policy Statement PS18/8 available at https://www.fca.org.uk/publication/policy/ps18-08.pdf

independent directors and the chair of the AFM's governing body, the latter in the context of the prescribed responsibility 'za'[4]. The conclusions of that assessment are also subject to external scrutiny given that the statement outlining these, whilst addressed to unitholders, is publicly accessible to any interested person.

The requirement to perform a value assessment is intended by the FCA to address a key finding in the AMMS, which found evidence of weak demand-side pressure on fund prices, particularly from retail investors, resulting in uncompetitive outcomes for investors in authorised funds. In the absence of demand side pressure from investors, the value assessment is intended to ensure that AFM Boards instead consider whether fund fees are justified by the value provided to fund investors, and taking remedial action to address any instances of poor value. Assessing whether a fee is justified in the context of value delivered is arguably subjective, but the FCA has indicated it wants AFMs to be considering what pricing pressures might look like in a market with more competition being driven by demand-side pressure. The FCA expects the assessment by AFM Boards, covering each of the minimum criteria set out in COLL 6.6.21R, to be driven by these first principles.

This message was reiterated by the FCA in the findings of its first multi-firm review of how AFMs had implemented the value assessment process, published in July 2021[5]. The FCA stated that most of the AFMs they reviewed had not implemented the value assessment arrangements that they expect to be necessary to comply with the rules. The findings identified a number of areas where the FCA stated that AFM boards needed to reconsider their processes, noting that the FCA would be conducting a further review in the second half of 2022, and that they expected AFMs to have reviewed their value assessment processes and addressed any gaps by this time.

The IA's Value Assessment Working Group met with the FCA in September 2021 to discuss and further clarify its findings. This edition of the IA Guidance on the Value Assessment and Reporting Requirements has been updated to reflect the additional direction given by the FCA in its published findings and to the IA's Value Assessment Working Group in its discussions.

The purpose of this paper is to help IA members understand the value assessment and reporting requirements, as stated in COLL 4.5.7(8)-(9) and COLL 6.6.20 to COLL 6.6.24, and provide a number of points that members may wish to consider as they set up or review their internal processes to comply with these rules.

To help IA members determine whether these rules apply to them in the first place, the IA has produced a separate paper "Scope of FCA fund governance requirements" outlining which firms and which activities are within scope.

For background information on the United States model, including the Gartenberg principles that the FCA explicitly referenced in PS18/8, members can refer to the IA research paper "*15(c) process for US mutual funds: current practice*".

In April 2021, the IA published a research paper[6] which analysed the first cohort of reports published after the requirements came into effect, identifying trends in reporting. Based on this analysis, the IA made a number of recommendations on the accessibility and presentation of information included in the reports. Members may wish to consider this report alongside this guidance paper.

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[4] This was expressed as prescribed responsibility 'PR7' in consultation paper CP17/25.

[5] FCA Multi-firm Review of Authorised Fund Managers' assessments of their funds' value July 2021 https://www.fca.org.uk/publications/multi-firm-reviews/authorised-fund-managers-assessments-their-funds-value

[6] Value Assessment Reports – Analysis and Initial Recommendations April 2021 https://www.theia.org/sites/default/files/2021-04/IA%20Analysis%20Report%20on%20Value%20Assessments_April%202021.pdf

VERSION MANAGEMENT

This is the third edition of the IA guidance, superseding the first edition released in November 2018 and the second edition released in July 2019.

The key changes made to this third edition are as follows:

- Template, document name and formatting
- *Introduction* - additional commentary added on FCA messages in its multi-firm review findings, and reference to the IA research paper on the first reports.
- *The Rules* - clarifying requirements in relation to reporting at fund v share class level.
- *Quality of Service* - new Q&A on ESG services, and amendments to existing FAQs reflecting the FCA's multi-firm review findings.
- *Performance* - additional commentary given in introduction on drafting of objectives, and amendments to existing FAQs reflecting the FCA's multi-firm review findings.
- *AFM Costs* - additional commentary given in introduction on first principles, and new FAQs clarifying AFM costs must be considered distinctly from comparable market rates, consideration of AFM costs against fund pricing, granularity of costs data, and the role of INEDs in cost discussions.
- *Economies of Scale* - additional commentary given in introduction on attribution of costs, new FAQ on board considerations of the firm's analysis, and additional clarification to FAQ on considering funds v fund ranges reflecting the FCA's multi-firm review findings.
- *Comparable Market Rates* - additional clarification to FAQ on using primary share class reflecting the FCA's multi-firm review findings.
- *Comparable Services* - additional clarification in background on institutional mandades and existing FAQ on lack of comparability reflecting the FCA's multi-firm review findings.
- *Classes of Units* - additional clarification to FAQ on pricing differences between share classes reflecting the FCA's multi-firm review findings.
- *Additional considerations* - ESG considerations added to list of potential considerations.
- *Independent AFMs* - section renamed, pre-implementation considerations removed, new FAQ on passing of benefits of economies of scale to sponsor, reflecting the FCA's multi-firm review findings.
- *Value Assessment - Timings and Reporting* - pre-implementation considerations on timing of first report removed, section added on IA recommendations following the first year of reporting, and new FAQs on first composite reports for newly launched funds and changing composite report dates.
- *Annex 2* – new annex with version control history of previous versions.

The changes made to previous editions are listed in Annex 2.

VALUE ASSESSMENT

THE RULES

COLL 6.6.20R(1) provides that an AFM must conduct an assessment "*at least annually*", for each scheme it manages, of whether the payments out of scheme property set out in the prospectus are justified in the context of the overall value delivered to unitholders. This is the core value assessment obligation.

Moreover, COLL 6.6.20R(2) states that AFMs should do this "*separately for each class of units in a scheme*", meaning that this assessment should be done at a share class level for each fund. Firms will note that, in terms of reporting, COLL 4.5.7R(8) refers to the annual long report of an authorised fund and PS18/8 further clarified that where a fund is set up as an umbrella, the statement will need to describe "*each sub-fund individually*"[7]. As such, although the assessment involves considerations on a share class level, the report is on a fund level and which means that there is no strict requirement to report on each criteria at share class level. It is therefore for each firm to consider whether to report at fund level or share class level, but firms should at least highlight share class specific issues where these have been identified.

In carrying out the value assessment, the AFM must consider "at least" the seven criteria set out in COLL 6.6.21R:

1. Quality of service
2. Performance
3. AFM costs - general
4. Economies of scale
5. Comparable market rates
6. Comparable services
7. Classes of units

The following section explores each criterion in turn, looks in the detail of the rule, provides broader context where relevant and suggests points that members may wish to consider during the assessment part of the process.

Although the seven criteria are set out separately, firms will notice interconnections in the sequence. Notably, criteria 4-6 expand in different ways upon criterion 3 (AFM costs), with Quality of Service, Performance and AFM Costs being central to the value assessment, alongside the broader question of the treatment of unitholders in different share classes (criterion 7). For the avoidance of doubt, the FCA's rules require firms to consider and report on each of the seven minimum criteria distinctly.

Furthermore, given the AMMS findings that these rules (among others) are intended to address, the COLL 6.6.21R considerations are designed to bring about a certain mindset within firms that makes them ask what they have delivered to unitholders in return for the price that they have had to pay. In this context, firms should note the connection between these requirements and the proposed rules on the clarity of fund objectives covered in consultation paper CP18/9, which in itself is also part of the wider

[7] PS18/8, page 14.

AMMS remedy package[8].

In assessing value, firms are likely to consider many aspects of what a fund offers. Some of these will relate directly to the investment performance where it can be expected that the focus will be on the fund objectives, the investment policies and strategies employed and the relevance of any portfolio constraint or benchmark. For other aspects of the fund, the investment objectives will be less relevant, and the assessment may then relate to wider themes such as those of safeguarding, governance and customer relations etc.

Finally, the rules have provided for cases where an authorised fund is being wound up or terminated and clarify that COLL 6.6.20R to COLL 6.6.24E (the core of the value assessment requirements) cease to apply. This is explored further in the "*Scope of FCA fund governance requirements*" paper.

1. QUALITY OF SERVICE

"The range and quality of services provided to unitholders."

This criterion should be viewed alongside the guidance in COLL 6.6.22:

"When assessing the quality of service provided under COLL 6.6.21R(1):

(1) the AFM should have regard to the quality of service it provides and the quality of service provided by any person to which any aspect of the scheme's management has been delegated or which provides services to the AFM or on its behalf; and

(2) the AFM's assessment of quality of service is not confined to services provided directly to unitholders but may include services undertaken on their behalf by the AFM, such as consideration of the quality of the investment process used to make decisions about managing the scheme property."

As the rule refers to services provided to unitholders, firms would need as a first step to identify and list what these services are. These could be broadly split into two types. First, they would include services that relate directly to the operation of the fund itself such as administration, custody, audit etc. and that are essential in ensuring that the fund runs and operates effectively. Second, they would include any additional services that relate to the broader investor experience such as any type of communication with unitholders, complaint management, website and app services etc.

In both cases, firms would need to make a judgement in regard to the materiality of each service and that it does relate to something that unitholders 'experience'. There may be different aspects to this. For example, sending communication documents, responding to enquiries or complaints, efficient redemption management, would all be something that unitholders experience. AFMs may need to take a view how much weight to place on each aspect of service delivery in light of varying degrees of materiality.

The guidance provided in COLL 6.6.22 further clarifies the AFM's responsibilities when any services are delegated, outsourced or otherwise provided to the AFM. COLL 6.6.22G(1) shows that the assessment of quality of services provided to unitholders will capture scheme management services carried out by a delegated person, even if technically they are contractually provided to the AFM. Additionally, this rule can capture other services provided to the AFM or on its behalf. Here again firms will wish to consider

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[8] CP18/9 consisted mainly of two parts. The first proposed guidance on making fund objectives in key investor communication documents more accessible and easier to understand for retail investors. The second included proposed rules on how performance and the use of benchmarks are disclosed to investors.

any such service that could affect the unitholders' experience.

At the same time, COLL 6.6.22G(2) explains that the overarching obligation to assess quality of services provided to unitholders includes a self-assessment by the AFM on the quality of its own oversight, review or supervisory activity carried out in relation to its delegates and outsourcers (who themselves are subject to a quality assessment by the AFM with regard to the services they provide as emphasised by COLL 6.6.22G(1)).

As with other criteria, the assessment should be considered at the level of each unit class, to the extent applicable, as reiterated by the FCA in its July 2021 multi-firm review findings. For example, where a service is only provided for investors in certain unit classes, eg investors in retail unit classes, there will be a differentiation of the consideration of this service against investors in unit classes where the service is not provided.

Background

Quality of service is the sole criterion originally proposed in CP17/18 that was not about cost although the drafting strongly suggested that an assessment of the quality of a service could only be seen through the lens of the level of charges:

"Whether the level of charges and other payments taken from the scheme property is commensurate with the quality of service provided to unitholders relating solely to the administration or the management of the scheme. … Whether the level of charges is commensurate with the quality and range of services provided to unitholders which do not directly relate to the administration or the management of the scheme."

The additional guidance provided was identical to the now existing point (1) of COLL 6.6.22G.

Interestingly, the conclusions around the quality of services in the interim report were generally positive. The report noted that *"asset managers appear to take the quality of service into account when buying 'core' ancillary services, including custody, trustee and depositary services, fund accounting and transfer agency"* [9] and concluded that competition appears to be working effectively in most ancillary service markets, allowing asset managers to control costs and quality.

FAQs

Q1.1 Does consideration of this criterion involve services provided by third parties, in addition to those provided by AFM?

Firms will have to consider the quality of each of the services provided by third parties which relate directly to the operation of the fund itself, such as investment management, administration, depositary, custody, audit etc.

Q1.2 Would this include services related to wider investor experience?

Metrics such as frequency of communication, average response times, number of complaints, average time it takes to address a complaint, or consumer research to gauge unitholder views could be relevant for the AFM board's assessment. The FCA suggested in its feedback following its 2021 review that complaints should be viewed as a detractor – the absence of complaints may not necessarily indicate a positive quality of service, it could indicate a lack of awareness and engagement from investors. Issues

[9] MS15/2.2, paragraph 7.33, page 131.

arising from operations related to the management of the fund are similarly likely to be considered a detractor, rather than a lack of issues being seen as a positive indicator of quality.

Q1.3 Does it involve distributors and other intermediaries?

This criteria is about the quality of service that the AFM provides or services that the AFM has delegated or outsourced to third parties, so distributors and intermediaries will not normally be within scope. It is ultimately for the investor to consider the quality of service being provided by their chosen intermediary. The AFM may wish to consider services that it (or its delegates or outsourcers) provides to distributors or intermediaries that relate to the distribution of the fund as this may impact the service experienced by the end-investors.

Q1.4 Should the investment process be assessed under quality of service, or is the performance outcome itself a quality indicator?

The guidance in COLL 6.6.22G (2) indicates that the quality of the investment process should be considered under quality of service. In particular, this will consider the inputs of the investment management process, which could include for example, the integrity of the investment process, the depth of the experience and quality of the investment team, the research process, the depth and quality of the risk management process, the size, resources and competencies of the investment and risk teams etc. This is a distinct assessment from the performance, which measures the output – a favourable performance outcome should not necessarily be assumed to be the result of a strong investment process, particularly in a market environment where the asset classes held by the fund have mostly risen in value.

While the AFM Board may wish to take breaches of investment powers into consideration, it is worth noting that in its findings on its multi-firm review published in July 2021, the FCA suggested that breaches might more appropriately be considered a detractor from quality, ie the absence of breaches would be considered a neutral rather than a positive factor.

Q1.5 Can work undertaken on corporate governance and stewardship be considered as part of the value assessment?

The AFM board may wish to consider if engagement with investee companies on corporate governance, stewardship and sustainability are part of their value proposition. If this is the case, the AFM board may wish to consider the value to the fund and its investors of work undertaken in engagement with investee companies on these issues.

Q1.6 Should services be considered solely from the perspective of customer experience, or can services that investors do not necessarily directly experience, but benefit from, such as resilience of IT systems, be considered?

Services do not necessarily need to be directly experienced by investors in the fund for these to be considered under quality of service, but AFMs should consider these from the perspective of the benefit to investors, either directly or indirectly. In determining their value proposition, AFMs may wish to consider the extent to which services are a base line of what is expected, and those that go beyond this. For example, compliance with regulatory requirements and resilience of IT systems are arguably baseline requirements that all AFMs must meet as regulated firms, whereas other features, such as an easy to use website or mobile app investment service arguably go beyond these baseline requirements. In this context, breaches of regulatory requirements may be seen as detracting from the quality of service.

Q1.7 Should firms consider ESG services as part of their Quality of Service assessment?

There is no strict requirement for AFMs to consider ESG in broad terms as part of the value assessment. Where a fund has an explicit ESG objective, investment policy or strategy, the AFM should consider the quality of those additional services being provided to the fund and its unitholders. Where there is not an explicit ESG objective, investment policy or strategy, but the AFM or the investment manager has set out an explicit commitment to investors to follow an ESG approach, the AFM may wish to consider assessing the quality of those additional services it is providing, especially if additional fees are being charged for those services. In other cases, the IA is of the view that it is a decision for each AFM, having regard to their own firm's value proposition, whether they choose to consider the ESG services they are providing.

The IA notes that both regulation and investor awareness in this area is developing rapidly, and therefore AFMs should remain mindful and reassess their value assessment processes in line with developments. The IA will continue to monitor developments in this area and will reassess its guidance if required to align with future frameworks.

2. PERFORMANCE

"The performance of the scheme, after deduction of all payments out of scheme property as set out in the prospectus (in this rule, COLL 6.6.23E and COLL 8.5.19E, "charges"). Performance should be considered over an appropriate timescale having regard to the scheme's investment objectives, policy and strategy."

This criterion requires the assessment of performance net of all the charges that are outlined in the fund's prospectus. This means net returns, measured as a change in NAV. Additionally, this rule clarifies two points:

Timescale
Performance should be measured over an "*appropriate timescale".* Although the assessment must be conducted "at least annually", PS18/9 recognised that performance should be considered over a time period that is appropriate to the fund's investment objective, policy and strategy. Given that funds are commonly designed to be held as medium- to long-term investments, it can be reasonably assumed that the consideration of past performance may look beyond the preceding 12 calendar months. Importantly, PS18/9 stated that AFMs "*can assess past and reasonably expected future performance and should not be solely based on actual past performance, short term or otherwise*"[10].

Objective
Performance should be viewed in the context of the "*investment objectives, policy and strategy*". This means that where the objective refers to outperforming a benchmark, delivering income, managing risk etc., firms should take this into account as well. Very relevant to this are the rules and non-handbook guidance issued by the FCA in PS 19/4 in February 2019. These provide guidance on the expression of the fund objective and investment policy, as well as rules regarding the disclosure of performance and use of benchmarks. Notably, PS19/4 uses a very broad definition of what could constitute a benchmark that included 'target', 'constraining' and 'comparator' benchmarks. AFMs should note the regulator's focus on clarity of intent in the fund objective, the subsequent delivery, and the degree to which this objective included any type of benchmark.

The assessment of performance may need to be tailored for different asset classes, eg, the assessment of the performance of a bond fund or a multi-asset fund may need to be modified from the approach taken to the assessment of performance in an equity fund to reflect the particular characteristics of those funds. Depending on the objective of the fund, it may also be appropriate to take into consideration other characteristics such as risk/volatility levels.

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[10] PS18/8, page 13.

The disclosure rules on benchmarks came into effect on 7 August 2019. The IA has issued guidance on the clarity of language used in fund communications, and the implementation of the benchmark disclosure rules, which are available on the IA's Asset Management Market Study webpage[11]. AFMs may also wish to consider the Q&As issued by ESMA on the disclosure of benchmarks in the UCITS KIID in their Q&As on the Application of the UCITS Directive in March 2019[12].

Notably, the FCA said in its July 2021 multi-firm review findings that some firms had not properly aligned their fund objectives with the investment strategy being pursued, which meant they were not properly assessing whether the performance of the fund had delivered value to investors. In particular, it highlighted examples of actively managed funds that had a broad "capital growth" objective, where the fund was deemed to have delivered value in positive markets despite having underperformed indices, suggesting the active strategy should be better reflected in the performance assessment. The FCA also criticised AFMs who attributed underperformance to undisclosed investment strategies, suggesting these should be disclosed to investors along with the risks of periods of underperformance. It also suggests that AFMs could think more broadly about the performance objectives, including what additional value a more expensive strategy might be trying to achieve relative to cheaper alternatives. It cites multi-asset funds as an example, noting that these are usually more expensive than single asset funds but are offered to investors on the basis that these will deliver better risk adjusted returns or better capital protection. The FCA suggests that rather than just compare the performance of a multi-asset fund with other multi-asset funds, they could compare performance with that of an alternative, such as a cheaper single asset fund, to see if the multi-asset fund has delivered additional value to investors in the form of superior risk adjusted returns, or lower volatility, etc. In view of these findings, firms may wish to consider whether changes are needed to improve the disclosure of each fund's objective, investment policy and strategy to investors.

Background

The AMMS interim and final reports presented a number of findings relating to fund performance. For example, the FCA found no clear link between price and performance, some performance persistence for underperforming funds, and lack of statistically significant outperformance net of fees for active funds. More relevant to the FCA's governance rules, the FCA concluded that AFMs *"occasionally fail to take appropriate and timely steps to address underperformance"*[13] which was actually part of the evidence presented in the AMMS interim report that was based on supervision (rather than competition) work[14].

Despite this, the initially proposed rules did not include investment performance in the list of the assessment criteria. During the consultation process, the IA and other respondents argued that performance was a key determinant in assessing customer value, a point reinforced by its inclusion in the Gartenberg principles in the US model. The FCA acknowledged that the draft rules could have been seen to be too focused on costs, and therefore brought the final rule closer to the Gartenberg principles hence including fund performance as an explicit criterion[15].

FAQs

[11] https://www.theia.org/industry-policy/positions/fca-market-study

[12] See ESMA Q&As on Application of the UCITS Directive, Section II: Key Investor Information Document (KIID) for UCITS, Q&As 4b, 4cbis, 8a, 8b, 8c and 8d, pages 14-22.

[13] CP17/18, paragraph 3.4, page 9.

[14] MS15/2.2, paragraphs 5.48-5.54, pages 88-89.

[15] PS18/8, pages 12-13.

Q2.1 What would be the appropriate timescale?

Given that the FCA rules refer to what would be appropriate according to the fund's investment objective, policy and strategy, firms may wish to consider performance over the fund's recommended holding period or the period over which the performance target has been set, as expressed in the scheme's documents and marketing materials. Alternatively, or additionally, firms could measure performance over commonly used timeframes, e.g. 1-, 3-, 5-, 10-years.

Q2.2 Should the performance be net or gross of fees?

As per COLL 6.6.21R(2), AFMs must consider performance net of all product charges. The FCA clarified this expectation in its July 2021 findings of its multi-firm review. Where a fund has an objective of delivering gross performance against a target benchmark, the AFM should ultimately consider the net performance experienced by investors when assessing whether value has been delivered.

Q2.3 What type of performance could be considered?

Firms should consider what is required by the rule, i.e. the return net of all product charges. As per the rule, firms would also be advised to consider performance in the context of the stated objective, particularly where this has been set in reference to a specific outcome, such as to deliver positive returns, or meet specified returns in relation to a target benchmark, for example, if the objective is to outperform a pre-determined index. Beyond that, other comparators may be relevant (for example, in excess of interest rate, over a given benchmark, adjusting for idiosyncratic risk or for systemic risk). In this regard, firms should be mindful of the final rules and guidance on fund objectives and benchmark disclosure in PS19/4 as noted in the introduction to this section, and ensure fund objectives are described and disclosed in line with these requirements.

Q2.4 Should fund performance be compared against a benchmark?

Firms should consider this both in relation to COLL 6.6.21R(2) and the applicable rules in COLL 4.2.5R (3)(c-b)[16]. Where the fund objective explicitly refers to performance relative to a benchmark, as in the case of a target or a constraining benchmark[17], then this should be part of the assessment.

For broader comparator benchmarks, it should be noted that 'comparator benchmarks' are defined in the final benchmark disclosure rules issued in PS19/4 as: *"without being a target benchmark or a constraining benchmark, the scheme's performance is compared against the value or price of an index or indices or any other similar factor"* [18]. The rules require disclosure of the use of any such benchmarks in the prospectus but not in performance reporting – contrary to target and constraining benchmarks, although it may still be appropriate to do so.

In its July 2021 findings from its multi-firm review, the FCA made clear that it expects fund objectives to reflect the investment strategy, implying that where an active strategy is being used to outperform markets, the strategy should be disclosed along with any risks of underperformance, and the objective should reflect this. AFMs may therefore wish to consider if their use of benchmarks aligns with this expectation, and if appropriate, consider whether further information should be provided, for example, to explain to investors if there are likely to be periods of underperformance against the benchmark due to the long-term investment strategy being deployed.

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[16] PS19/4, Appendix 1.
[17] Defined in COLL 4.2.5R(3)(c-b)(i) and (ii)
[18] Defined in COLL 4.2.5R(3)(c-b)(iii)

Q2.5 Can specific outcomes beyond return be considered?

As per COLL 6.6.21R(2), AFMs must consider performance *"having regard to the scheme's investment objectives, policy and strategy"*. Where the fund objective involves specific outcomes such as absolute return, risk management, providing income etc., firms may wish to also consider to what extent these outcomes have been delivered to unitholders, particularly where these are part of the investment strategy being adopted. As with investment performance, this should be done over the appropriate timescale which will be determined by the objective.

Q2.6 Do AFMs need to consider performance for newly launched funds?

Each of the seven value assessment criteria, including performance must be considered by the AFM's board for all funds that are within scope, regardless of how long these have been in existence for. However, COLL 6.6.21R(2) requires that *"performance should be considered over an appropriate timescale"* and in the case of a newly or recently launched fund, there will only be a relatively short timescale over which performance can be considered. In this case, the AFM board may wish to consider whether there has been sufficient time to make judgements on the performance and if it concluded this is not the case, explain it in the statement to unitholders.

Q2.7 Should AFMs compare performance to a peer group?

The new rules are silent on peer-group comparison (much like the Gartenberg factors) whilst they are very specific on peer-group charge comparisons, as discussed below. This means that although AFMs are required to measure performance as an absolute change in NAV (that is, after deduction of all costs and charges), they are not required to compare this performance to that of a peer group.

Where the fund objective refers to peer group performance as a target benchmark then performance should be compared against the peer group. Where this is not the case, it may still be reasonable to look at performance in relative terms, although there is no obligation for AFMs to do so. If AFMs decide to do so, care should be taken in the identification of the appropriate peer group, including taking into consideration the consistency of the selected peer group with other comparisons made in the assessment. This is likely to be determined by the investment objective, management type (active or passive), and charge structure (bundled vs unbundled). Where asset class or sector performance figures are taken from data vendors, AFMs should review carefully how these are calculated and to what extent they are appropriate, particularly when accounting for management type as asset class or sector performance may be calculated across active and passive funds together.

Q2.8 Can the performance of an active fund be assessed by comparison to a passive product with a similar investment universe?

There is no prescription in COLL 6.6.21R(2) on how performance should be assessed, and therefore the AFM may consider an active fund relative to a passive product if the AFM considers this to be an appropriate comparison. Unlike a benchmark index, a passive product will include charges of operating a scheme and transaction costs. AFMs comparing performance to a passive product may wish to consider explaining in their reports their reasoning for making this comparison, and for the selection of the passive product used.

Similarly, the FCA suggested in its July 2021 findings from its multi-firm review that for multi-asset funds, AFMs might consider the possibility of comparing the performance of these to a single asset fund to see if the multi-asset approach, and any additional cost which may be associated with this, is delivering the desired performance outcomes over and above alternatives such as a single asset fund.

Q2.9 Can income and accumulation share classes be considered as a single share class for the purposes of assessment, or should these be considered separately?

The value assessment rules require each criteria to be considered for each unit or share class. The purpose of the assessment at this level is to ensure that there are no instances of poor value that are overlooked in individual share classes – in particular, fees affect net performance, and there is a possibility that a lower fee share class may meet its performance objectives, but a higher fee share class might not. Where a fund has income and accumulation versions of share classes that otherwise share the same features, if there is no material difference in the OCF between the share classes then a material difference in performance is unlikely to arise. Provided the AFM is satisfied this is the case, these may be considered as a single share class for the purposes of assessing performance. Where an accumulation class is compared to an income class, to ensure comparability the performance of the income class should be considered on an income reinvested basis.

3. AFM COSTS – GENERAL

"In relation to each charge, the cost of providing the service to which the charge relates, and when money is paid directly to associates or external parties, the cost is the amount paid to that person."

This criterion requires first and foremost the identification of *"each charge".* This would reflect what the fund is paying for, including all payments made to other parties and the AMC.

AFMs will have to list all the costs incurred and identify how much the fund has been charged for these. This includes an element of reviewing the fund's cost base and ensuring that services have been provided on a competitive basis.

Moreover, having identified the fund's cost base, AFMs will have to consider the AMC, i.e. how much the fund is charged on top of the cost base. Consideration of charges is not limited to components of OCF, but will extend to all charges as relevant to the fund and share class (i.e. initial costs, performance fees etc.).

In its July 2021 findings of its multi-firm review, the FCA emphasised the importance of AFM boards going back to the first principles of the AMMS. The FCA states that it expects firms to consider whether payments out of the scheme are justified in the context of value delivered, in particular whether the latter is sufficient to justify the costs. In order to perform such an assessment, it is clear the FCA expects firms to have the capacity to allocate relevant costs fairly to individual funds and share classes.

Background

As initially drafted in the proposed rules in CP17/18, this criterion was closer to a cost-plus approach: *"Whether the level of each charge and other payment taken from the scheme property is reasonable in relation to the costs necessarily incurred, in particular in delivering the scheme's investment objectives and policy and the distribution and marketing of the scheme."* Although this criterion is now worded less explicitly, it would still require AFMs to reflect on the margin set over the cost basis.

Importantly, this criterion would suggest that AFMs also need to ensure they are policing the cost and quality of ancillary services on behalf of investors. In this context, it should be noted that, as stressed above, the AMMS interim report concluded that asset managers are generally good at managing the costs of ancillary services.

FAQs

Q3.1 Would this criterion require consideration of the AMC or the OCF?

This criterion would require consideration of every component within the OCF. This covers charges that relate to the AFM's service, that is, the AMC as well as charges that relate to the other services provided to the fund (and are closely connected to criteria 1 and 2).

Firms may wish to additionally consider any event-based fees such as entry and exit fees as well as performance fees.

Q3.2 Would this criterion require consideration of the synthetic OCF?

The AFM costs criterion is about the consideration of the costs of the AFM and its delegates or service providers. For a fund of funds, the published OCF will include the management fees and operating costs of the fund itself, and a "synthetic OCF" that relates to the OCF of the investee funds The AFM will need to consider the component of the OCF that is made up of the management fees and operating costs of the fund itself. Given the synthetic component of the OCF relates to the costs of the underlying funds rather than the fund of funds itself, the AFM may wish to consider if this is relevant for the assessment of the AFM's costs, or if it should be considered as part of the investment process (which might be considered under Quality of Service).

Q3.3 Would this include transaction costs?

We note that the value assessment rules as set out in PS18/8 apply to investment funds specifically. Different value for money rules apply to DC pension schemes where transaction costs considerations are specifically required[19].

The AMMS focused very strongly on competition as measured by charges (OCF), with a particular interest in the control and oversight applied to the components of the OCF. Accordingly, the value assessment rules focus on charges. We would therefore expect that in discharging requirements under 6.6.21R, criteria 3-7 will involve primarily a consideration of ongoing charges, and the components of charges.

However, the AMMS also emphasised the importance of disclosure – and control – of transaction costs. In this context, we observe that 6.6.22G refers to the fact that the quality of service criterion of 6.6.21R includes "consideration of the quality of the investment process used to make decisions about managing the scheme property". This could point towards factors such as best execution and potentially wider factors affecting investment decision-making and associated transaction costs. Firms may wish to consider whether it may be appropriate to scrutinise the commission rates obtained as part of best execution and the level of turnover generated in delivering the investment objective when assessing the quantum of transaction costs.

In an environment where disclosure of overall levels of transaction costs is also a requirement, firms may further wish to consider whether - and how - to comment explicitly in their value reports about transaction costs. In this context, it is worth noting the debate on the conflation of charges and transaction costs under regulatory reporting requirements, particularly aggregated reporting under PRIIPs and MiFID II. Firms may wish to consider how the costs of delivering a specific investment objective in the context of quality of service and performance can be distinguished from the charges levied for the delivery of that investment performance.

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[19] COBS 19.5.5R(2)

Q3.4 Can unaudited costs be considered, or can only audited costs be considered?

There is no requirement in COLL 6.6.21R for the figures used in the value assessment to be audited.

Q3.5 Can AFM costs be considered alongside comparable market rates?

AFM costs should be considered and reported separately to other criteria that relate to costs and charges. In particular, AFM costs involves considering for each service which is paid for out of the fund (whether directly, or indirect through the annual management charge), the cost of providing that service and how that cost compares to what has been charged by/to the fund. This should not be conflated with an examination of how the fund charges compare to those of other funds – this is covered separately in Comparable Market Rates.

Q3.6 Should AFMs be considering a particular level of margin when considering AFM costs?

The FCA has informed the IA it does not have a fixed view on what an acceptable level of margin is, but it expects AFM boards to satisfactorily justify their conclusions regarding the prices of funds in relation to the AFM costs. From its July 2021 findings of its multi-firm review, it is clear that the FCA does not consider pre-existing margin levels or industry averages to be an acceptable starting assumption when setting fund prices. The FCA has suggested that AFM Boards might consider what prices might be expected in an environment with greater price competition.

As such, there is no fixed view on acceptable margins for fund management companies, but AFMs must be able to demonstrate and justify how they have reached their conclusions when assessing AFM costs in the context of the charges made to the fund.

Q3.7 To what level of granularity of cost data should AFMs be looking to assess?

The FCA has advised the IA it expects AFMs to take a reasonable approach. Given the expectation that costs are assessed at fund level and, where applicable, share class level, this implies sufficient granularity to identify costs that relate to a particular fund or share class. For other costs that cannot readily be allocated to a fund or share class, sensible approximations and assumptions may be required. We recommend that where firms use such using approximations or assumptions, they document their rationale for these assumptions and ensure board members, including independent directors, are aware of, and have approved, these assumptions.

Q3.8 What is the role of INEDs in discussions on profitability?

INEDs have a key role in the value assessment, in particular providing an independent challenge to AFM Boards. INEDs therefore have a key role in discussing and challenging the Board on the costs and charges made to investors in the fund, and are likely to want to be involved in shaping the process that considers these. The FCA expects INEDs to be actively involved in such discussions and challenge the Board on behalf of investors. AFMs should ensure that INEDs have access to appropriate information that they require to assess the appropriateness of the costs and charges paid by the fund, and we recommend INEDs are consulted on key decisions regarding processes and assumptions used by the firm to assess costs and charges in this context.

4. ECONOMIES OF SCALE

"Whether the AFM is able to achieve savings and benefits from economies of scale, relating to the

direct and indirect costs of managing the scheme property and taking into account the value of the scheme property and whether it has grown or contracted in size as a result of the sale and redemption of units."

In the first instance, AFMs are required to assess to what extent they are "able to achieve" any savings as a result of economies of scale. The possible outcomes of such an assessment are as follows:

- No such savings could be achieved
- Savings could be and have been achieved
  - Such savings have been or will be passed on to the scheme's unitholders
  - Such savings will not be passed on to the scheme's unitholders
- Savings could be but have not been achieved

The last two outcomes would require further investigation as to why this was the case and AFMs would need to either justify why this would be appropriate or if not, where possible, identify future course of action.

As noted under Economies of Scale, the FCA expects AFMs to deliver more sophisticated methods for measuring and attributing costs to funds and share classes. Such analysis will in due course enable AFM Boards to better determine whether economies of scale are being realised for a particular fund or share class. It is also notable that in its July 2021 findings from its multi-firm review, the FCA criticised some AFMs for using assumptions that their historic fees and margins, or those of competitors, had previously been at the right level, and that economies of scale would only be realised where those historic levels were exceeded. It is therefore important for AFMs to consider the first principles from the AMMS findings and the intentions of the rules when determining the level at which economies of scale are being achieved and whether the benefits of those economies of scale are shared with investors.

Background

Economies of scale have been a particularly prominent criterion in the consultation phase and the final rules. This reflects the fact that both the AMMS interim and final reports considered it, albeit in different ways. The interim report discussed the relationship between fund size and price as part of the price clustering analysis and the connection between firm-level profitability and firm size[20]. The final report included a comparative analysis between retail fund charges and the management charges of segregated mandates showing that the latter "tend to be substantially lower" than the former and that additional analysis of profitability data suggested that margins for retail business are higher than the margins for institutional business[21]. The retail-institutional comparison is now reflected in criterion 6 but it was initially presented as part of the economies of scale evidence.

The most relevant remark seems to be the one already explored as part of the supervisory work on fund governance, namely that AFM boards *"do not typically question whether the economies of scale achieved when funds grow to reach certain levels of assets are shared with the fund investors in the way that break points are routinely used in institutional and segregated mandates[22]".* And this was repeated in the final report but without providing any further details: *"At a fund level, we have found that asset managers tend to benefit from economies of scale and these do not seem to be passed on fully to*

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[20] For example, see MS15/2.2, para 6.75, page 113 and para 6.89, page 117.

[21] MS15/2.3, page 36, and Annex 3 to the final report. Notably, these findings had not been presented in the interim report.

[22] MS15/2.2, para 5.50, page 88

investors.[23]"

It is important to note that the draft rules in CP17/18 were making explicit references to introducing breakpoints which the FCA acknowledged in PS18/8 were too detailed and prescriptive. PS18/8 also made clear that the consideration of economies of scale does not prevent AFMs *from "reinvesting savings achieved through economies of scale into the business, subsidising other parts of the business or covering development costs"[24]*. This however would need to be explained in the annual report (COLL 4.5.7R(8)(b) - see p23), and "*show how these decisions, along with others flowing from the assessment, are in the best interest of investors"[25].*

FAQs

Q4.1 Is this criterion fund-specific or would AFMs need to review this looking across their entire fund range?

Although the rule refers to the scheme property and would thus be viewed as fund-specific, the text in the policy statement acknowledges that there are wider business considerations that could be accounted for. It may be reasonable to pass on firm- or even fund-level economies of scale to newly launched funds in the form of fees that do not cover the cost base. Similarly, it may be reasonable to take a view of the materiality that each fund has for the long-term success of the business as whole and to what extent a reduction in the level of charges or the introduction of breakpoints would significantly threaten this.

That said, any decision by the AFM Board to reinvest economies of scale realised by a fund into the range needs to take into consideration whether this decision benefits the investors in the fund from which the economies of scale has been realised. When establishing a new fund, AFMs often absorb costs and losses for a period until that fund reaches scale, and it is understandable that there will be a period after the fund reaches scale where the AFM will be seeking to recover those costs before the AFM considers passing on the benefits of economies of scale. The AFM Board will need to determine the point at which previously absorbed costs have been recovered and it should consider passing on economies of scale.

Q4.2 If economies of scale are identified, how can these be passed on to investors?

This is ultimately a decision for each AFM, taking into account the wider business model and any pre-existing or planned cross-subsidies between funds. Examples may include introducing breakpoints, an outright decrease in the overall charge level, or keeping charges at the same level to manage fund size. Whatever decision AFMs take, this should be explained in the statement to unitholders.

Q4.3 Is capacity management a relevant factor for this criterion?

The AFM is obliged to consider whether it is able to identify any economies of scale even where it is considering or has taken measures to restrict further subscriptions into the fund. If the AFM's governing body is of the view that passing on any economies of scale achieved to investors cannot be reconciled with its deployment of capacity management tools, then it will need to disclose and justify this in the statement to unitholders.

Q4.4 Should the assessment consider dis-economies of scale where fund sizes are declining?

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[23] MS15/2.3, page 42.
[24] PS18/8, page 14.
[25] PS18/8, p14

The criterion in COLL 6.6.21R(4) states that the AFM should consider whether the fund "*has grown or contracted in size as a result of the sale and redemption of units*". As such, the rules are clear that fund contraction is relevant.

Q4.5 Should the assessment consider the level of charges to institutional clients?

Although there is an implicit connection between criteria 4 and 6, AFMs may wish to carry out any retail versus institutional charges comparison as an assessment separate from any economies of scale consideration.

Q4.5 Where the analysis by a firm indicates that there are economies of scale being realised, what discretion does the AFM Board have to reach its own conclusions?

Ultimately it is for the AFM Board to determine whether economies of scale have been realised, and what action should be taken regarding any identified economies of scale. But as noted, the FCA has indicated that it expects all parties involved in the value assessment process to consider the purpose of the value assessment, particularly the Board. In its July 2021 findings from its multi-firm review, the FCA noted that some AFMs had performed a sophisticated analysis of economies of scale in the fund range, but this analysis seemed to have little bearing on Board discussions. This suggests that the FCA expects AFM Boards to properly consider the analysis undertaken by the firm and that Board decisions should reflect the findings of the analysis.

5. COMPARABLE MARKET RATES

"In relation to each service, the market rate for any comparable service provided: (a) by the AFM; or (b) to the AFM or on its behalf, including by a person to which any aspect of the scheme's management has been delegated."

This criterion involves an external comparison, that is, a comparison between the charge of the AFM's fund and the "*market rate*" of comparable services. Effectively this means a comparison between the charge of the fund and that of similar funds.

Key here is going to be the definition of what would constitute a "*comparable*" service. Although it is not part of this criterion, comparability is defined under criterion 6 and relates to size, investment objectives and policies.

As mentioned earlier, there is an asymmetry in the rules around peer-group comparisons of charges and performance, in that for the former it is explicitly encouraged and required whilst for the latter it is not. Still, where AFMs choose to carry out a peer-group performance comparison, they may wish to also consider using the same peer-group for the charges comparison. And again, the appropriate peer group can be determined by the investment objective, management type (active or passive), and charge structure (bundled vs unbundled). Specifically the latter is much more significant for a "comparable market rate" assessment, given that the assessment should be done on a share class level.

Background

Same as the "*comparable services*" criterion 6, in the initially drafted rules in CP17/18 "*comparable market rates*" was part of the guidance under COLL 6.6.22G and not in the regulation in COLL 6.6.21R. The AMMS interim and final reports, when discussing price clustering, took the view that this was indicative of a lack of competition although the final report acknowledged that "*price clustering on its own does not mean that competition is not working effectively, and that it could be present in markets*

where there is competition on price"[26]. The final report clarified that it was rather the combination of results, including those around profitability that made the FCA conclude that clustering implied lack of competition instead of the opposite.

FAQs

Q5.1 What would determine what a comparable market rate is? Are there any guidelines for the identification of a peer group?

Considering the drafting of COLL 6.6.21R(6), AFMs may wish to take into account the investment objective (possibly expressed by sector classification), management type (active vs passive), and size.

Q5.2 How would the data be sourced if it's not publicly available?

AFMs may wish to assess first what information can be collected and to what level of detail. Firms could document where information cannot be obtained to ensure that this has been considered and all available data has been taken into account.

External data sources may be used but firms should note that it is not required by the rules. Independently of the approach that firms decide to follow, when carrying out this research, firms should be mindful of competition law constraints, including for example the principles relating to information sharing.

Q5.3 Could the comparison be done on a primary share class level only?

COLL 6.6.20R(2) states that the AFM must consider (at least) the criteria in COLL 6.6.21R "*separately for each class of units in a scheme*". This would mean, that all criteria, including this one, would have to be considered on a share class level and cover all share classes, including (but not only) the primary share class. It is particularly important that all higher charge share classes are considered against comparable market rates, including those that may no longer be actively marketed, such as pre-RDR share classes.

Q5.4 Should the comparison be on an AMC or OCF level?

As the rule requires the comparison to be done "*in relation to each service*", as discussed for criterion 3, this should cover both the AMC and the OCF. It is reasonable, however, to expect that AFMs will not have sight of the different components of the cost base of other AFMs.

Q5.5 Should the comparison consider transaction costs?

Transaction costs are not related to the provision of a specific service. They are costs necessarily incurred as part of the investment process. However, given the recently introduced disclosure rules on aggregated charges and costs disclosure (MiFID II and PRIIPs), AFMs may wish to add this to the list of additional considerations, bearing in mind the existing debate around potential issues with the methodology for estimating implicit transaction costs. See also Q3.3.

6. COMPARABLE SERVICES

[26] MS15/2.3, page 35.

"In relation to each separate charge, the AFM's charges and those of its associates for comparable services provided to clients, including for institutional mandates of a comparable size and having similar investment objectives and policies."

Contrary to criterion 5 which involves an external comparison, this criterion requires an internal comparison. The key issue in both cases is the identification of what is *"comparable*".

Firms should note that the rule states that this will be determined by similarity of size, investment objectives and policies. AFMs should also bear in mind that institutional mandates would most likely include a service that is provided by a separate legal entity, i.e. what the rule refers to as the *"associate".*

This point is discussed in more detail in the IA paper "*Scope of FCA fund governance requirements*".

Background

This criterion particularly relates to one of the AMMS findings presented in the final but not the interim report. Namely, it was stated in the final report that the FCA used data from a *"sample of asset managers*" to compare charges paid by retail and institutional clients and found that "*management charges faced by segregated mandates tend to be substantially lower than retail funds, even after controlling for size and asset class*"[27]. Moreover, relevant profitability findings suggested "*that margins earned by asset managers are higher for the retail segment*" but noted that this could reflect differences in negotiating strength between mandates and funds. The FCA also found that the management charge for segregated mandates tends to fall as the size of the mandate increases[28].

As with the previous criterion, the requirement to make this comparison was moved from guidance to regulation following the consultation process. While the text in PS18/8 could be interpreted as allowing for the possibility that AFMs may reach the conclusion that retail funds and institutional mandates are not comparable[29], we caution against this being taken as a general rejection of the concept of any comparison with institutional mandates, rather than specific mandates. The feedback given by the FCA in its July 2021 findings from its multi-firm review is clear that it expects firms to look at institutional mandates of similar sizes and with similar investment strategies, and compare the pricing of these to the pricing of the fund. The pricing of the latter can account for differences, but the AFM Board should consider the extent to which any extra complexity, compliance costs, etc associated with running a fund compared to an institutional mandate justify the price difference.

FAQs

Q6.1 Would *"comparable services"* include the AFM's overseas domiciled funds?

If there are funds or mandates with size, investment objective and policy similar to the fund being assessed, then these should be considered.

Firms may also wish to consider the similarity in the regulatory requirements applicable, the distribution model and target investor audience when determining if a service is comparable.

Q6.2 What factors may account for lack of comparability between retail and institutional products?

Although there is no corresponding precedent, the comparison may take into account operational and

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[27] MS15/2.3, page 36
[28] Ibid.
[29] PS18/8, page 14.

compliance costs, investor turnover rates, etc. As stated above under Background above, the FCA expects firms to consider institutional mandates that are of a similar size and managed to a similar investment strategy, so we would caution against AFMs automatically dismissing all comparisons between institutional mandates and funds.

Firms will have to take a view depending on their individual circumstances and accounting for the specificities of their business model. In any case, firms need to ensure that the thought process and conclusion is outlined in their internal records and a high-level explanation provided in the report.

7. CLASSES OF UNITS

"Whether it is appropriate for unitholders to hold units in classes subject to higher charges than those applying to other classes of the same scheme with substantially similar rights."

This criterion specifically requires AFMs to consider the pricing of a unit class against the pricing of other unit classes within the same fund, as well as the points of differentiation between these unit classes. Where the rights of share classes are apparently similar (e.g. similar minimum investment requirements, distribution arrangements etc.) while the pricing is different, the board will be expected to consider whether it is appropriate for unitholders to remain in the class with higher charges when there is an apparently cheaper alternative.

There is a clear link between this criterion and the change in the guidance FG18/3, which permits AFMs to move unitholders into a different unit class upon giving notice, but without an explicit instruction, where it is in the unitholders' interests to do so. An example might be where a unitholder is in a bundled share class, but where trail commission is not or is no longer being paid to an intermediary in relation to their holding, and a cheaper 'clean' share class with similar terms is available. Having given more flexibility for AFMs to move investors in legacy arrangements into alternative unit classes, there is a clear expectation from the regulator that AFMs should consider groups of unitholders for whom this may be relevant.

Background

In the Interim Report, the FCA noted that AFMs had identified difficulties in moving investors from legacy bundled share classes to equivalent post-RDR 'clean' unit classes. The FCA listed four scenarios where an investor might be in a more expensive unit class[30]:

1) Investors are in a pre-RDR share class which is more expensive because they continue to pay trail commission.
2) Investors are in a pre-RDR share class which is more expensive but the manager has 'turned off' trail commission.
3) Investors are in a more expensive share class than others available through alternative distribution channels.
4) The fund manager has launched a cheaper share class (but not for the reasons listed above) which would be available without switching distribution channel. This could be because an investor bought units in a legacy share class and subsequently a cheaper share class was launched. Alternatively, multiple share classes could have been distributed at the same time and the investor ended up in a more expensive one.

The FCA suggested it was primarily scenarios 2 and 4 that would need addressing. This acknowledged

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[30] FCA Asset Management Market Study, Interim Report, MS15/2.2, Figure 9.3, page 180.

that there are legitimate reasons for differentiation between the pricing points of unit classes (such as those identified in scenarios 1 and 3), but that AFMs should consider taking action where there is little differentiation between a more expensive and a cheaper unit class, or the differentiation is historic and no longer applies.

FAQs

Q7.1 Should AFMs consider moving unitholders from arrangements where trail commission is paid?

In PS18/8, the FCA confirmed they had no current intention of reconsidering the issue of trail commission. This suggests there is no expectation on the part of the regulator for AFMs to move unitholders from trail commission where this is being paid to an intermediary still acting for the unitholder, and where no instruction has been received from the unitholder or intermediary to cease trail commission payments.

It is, therefore, a matter for each AFM to consider taking account of the fact that the new guidance FG13/8, which was part of PS18/8, might indicate a degree of attention to how firms are addressing legacy share classes.

Q7.2 Should AFMs move unitholders from legacy bundled share classes to equivalent post-RDR 'clean' share classes where there may be a possible tax impact on investors?

In FG18/3, paragraph 1.9, the FCA stated it would expect the AFM, when undertaking a unit conversion, to have regard to the relevant tax regulations. Under those regulations, an exchange of units in a single transaction might have capital gains tax implications, but this will not usually be the case where the client receives only the new clean units of the same fund with the same rights as before but a different AMC. However, for non-UK tax resident investors a unit conversion may have a capital gains tax impact. Therefore, if an investor is a non-UK tax resident, or the tax status of an investor is unconfirmed, the AFM may not be expected to convert these investors as it cannot be certain the conversion would be in their best interests.

Q7.3 Should the cost of currency hedging be considered?

If classes of the same fund are similar but differ in the currency hedging arrangements, the cost of hedging should be taken into consideration when comparing these share classes. The ESMA Opinion on the Share Classes of UCITS[31] specified under the principle of non-contagion that the administrative costs relating to the share class hedging instrument should be attributed to and borne only by the hedged share class.

Q7.4 When assessing investors in higher charging share classes, what is meant by "substantially similar rights"?

We understand the reference to "rights" to refer to COLL 3.3.5R. This sets out how the rights of share classes in a fund may be differentiated, and requires the apportionment of scheme property between share classes to be set out in the instrument constituting the fund. The reference to "substantially similar rights" suggests share classes with similar criteria, eg minimum investment and holding requirements, differentiated only by the charge.

Q7.5 Do AFMs need to consider pricing differences between share classes, even where the rights between the share classes differ?

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[31] See https://www.esma.europa.eu/document/opinion-ucits-share-classes

The criterion requires AFMs to consider whether it is appropriate for investors to be in higher charging share classes than those with substantially similar rights. This suggests share classes with similar investment requirements but different charges should be considered. The rules do not explicitly require AFMs to compare share classes with different rights, such as different minimum investment requirements, but paragraph 6.98 of the Interim Report identified that operating margins were higher for retail products than for institutional products. The FCA, in its July 2021 findings from its multi-firm review, clearly signalled it expects AFMs to be looking at the pricing of each share class, noting “it does not directly follow that the remaining investors in higher charging classes receive good value, simply because they are in the class appropriate to the size of their investment or reflecting how the fund was sold to them”. As noted in the background, the FCA has recognised there can be legitimate reasons for differentiation between the pricing points of unit classes, and some investor groups will bring benefits of scale resulting in greater bargaining power, however in view of the FCA’s observations, AFMs may wish to consider the degree of difference that exists between prices of share classes in the same fund, and the rationale for that in the context of the value delivered.

ADDITIONAL CONSIDERATIONS

COLL 6.6.21R outlines the minimum considerations. This means that in their assessment of value under COLL 6.6.20R, AFMs may wish to take into view additional points. Ultimately, this will be for the governing body of each AFM to determine.

The US experience could provide some examples in this area but AFMs should bear in mind that the US model is shaped around the 15(c) process, which is about renewing the investment adviser’s contract. As such, there could be broader questions at the firm level, like the firm’s long-term prospects and financial viability, which would not be relevant for the fund level assessment that is required in the UK.

Therefore, any additional factors that AFMs may wish to consider here should be primarily fund- rather than firm-related. These may include:

- Risk management tools. For example, is the fund likely to have an issue with liquidity mismatch? Are there adequate stress testing procedures in place? What happens in case of high redemptions?
- Does the fund use derivatives? Is there significant counterparty risk attached to it?
- Are there high levels of portfolio turnover? To what extent does this suit the fund objective?
- What are the qualifications and previous track record of the portfolio manager?
- ESG – does the approach adopted by the firm in respect of ESG bring additional benefits to the fund and its investors?

INDEPENDENT AFMS

The requirement to perform a value assessment and report on it may pose different challenges for AFM firms that are independent of the sponsor and investment manager. In such arrangements, the AFM is usually selected by a sponsor, often (although not always) an investment manager, to be the regulated operator of a UK authorised fund. The AFM, in turn, will appoint the investment manager (either the sponsor or the investment manager selected by the sponsor) to manage the assets of the fund under a delegation arrangement. The AFM may also enter into a sponsorship agreement with the sponsor that formalises the appointment of the AFM by the sponsor.

In such arrangements, the sponsor might view the independent AFM as an outsourcer or a delegate. Ordinarily, an outsourcer will be a delegate, and the delegator will retain ownership and responsibility for the activity being performed by the outsourcer. In such arrangements it would be unusual for the outsourcer to challenge the activities and charges set by the delegator who may also act as the

investment manager to the fund. Independent AFMs differ from other outsourcing arrangements in that the independent AFM has regulatory responsibility for the fund, and since it formally appoints the investment manager as its delegate to manage the assets of the fund, it has an obligation to oversee the activities of that investment manager. In CP17/18, the FCA observed that the commercial reliance of the independent AFM on the investment manager could undermine the notional independence of the independent AFM.

The requirement to perform and report on a value assessment applies equally to independent AFMs. This may require the independent AFM to challenge the investment manager on its service quality, its performance, and ultimately its charges. The FCA clearly expect independent AFMs to manage any conflicts that may arise in an assessment of the investment manager and their relationships with the investment manager/sponsor.

In June 2021, the FCA published its findings on its multi-firms review of host AFMs. While focusing on a number of areas, some specific feedback was given on the value assessments performed by independent AFMs.

FAQs

Q8.1 Are independent AFMs obliged to consider "*comparable*" institutional mandates managed by their delegate investment managers?

Criterion 6 requires AFMs to consider other services that they or their associates manage, including segregated mandates. Usually, the investment manager will not be in the same corporate group as the independent AFM, in which case they will be outside the definition of an "*associate*". Information on other client portfolios of the investment manager is likely to be commercially sensitive and subject to confidentiality agreements with those clients preventing information from being shared outside the investment manager's corporate group. As such, this information may not be accessible to the independent AFM. To address comparable services, the independent AFM may wish to consider the charges associated with other fund ranges it acts as independent AFM for.

Q8.2 Should an independent AFM allow a sponsor or investment manager to review the value assessment statement?

It is for the independent AFM to determine how it can appropriately communicate the outcome of the value assessment with the sponsor/investment manager. The independent AFM is responsible for the value assessment and should be able to demonstrate that a robust and independent assessment has been performed. Independent AFMs may wish to consider procedures that avoid the assessment or the public statement being inappropriately influenced by sponsors/investment managers. The chair of the AFM board as well as the INEDs could also help in that respect.

Q8.3 Can an independent AFM that has concluded a fund offers poor value discharge its responsibilities by resigning as the AFM?

The independent AFM has the regulatory obligation to consider appropriate remedies where it identifies instances of poor value. Even if the independent AFM decides it no longer wishes to perform this function, it may still need to consider remedies to address the instances of poor value identified to demonstrate it has taken sufficient steps to remedy these to satisfy COLL 6.6.23E.

Q8.4 Are independent AFMs required to pass the benefits of economies of scale to investors, or can these be passed on to other parties, such as the sponsor?

While ultimately a decision for the Boards of independent AFMs to take, the feedback of the FCA given in

its findings on independent AFMs noted that firms had offered reductions in AFM fees, but had passed the benefit to the sponsor in the form of a higher share of the AMC, rather to investors in the form of a reduction to the AMC, without any apparent additional service being performed by the sponsor for the benefit of investors in the fund. If the Board of an independent AFM therefore elects to pass the benefit of economies of scale to another party, such as the sponsor, rather than investors, we suggest the independent AFM should consider whether such an approach benefits the fund's investors and provide an explanation of its reasons for taking this decision in its report on the value assessment.

VALUE ASSESSMENT – TIMING AND REPORTING

COLL 6.6.20R requires an AFM to conduct an assessment of the value delivered for each scheme it manages at least annually, but does not specify a reference date (such as the accounting year-end) for which the assessment of value should be performed. Alongside the requirement to carry out an assessment of value delivered, the new rules require that AFMs publish a statement summarising the assessment process and the conclusions reached. This statement must be reported on an annual basis and can be part of each fund's annual long report or AFMs can produce a composite report covering two or more funds.

The final rules as presented in Appendix 1 of PS18/8 did not specify that the value statement should be published within four months from each fund's accounting year-end. The timing of the publication of the statement is determined by whether the AFM chooses to publish the value statement in the annual long report or in a separate composite report.

ANNUAL LONG REPORTS

Where the AFM includes the statement in the annual long report, COLL 4.5.14R requires that the annual long report must be made available and published within four months after the end of each annual accounting period.

COMPOSITE REPORTS

Where AFMs choose to publish the statement for two or more funds in a composite report, COLL 4.5.7R(9) states that this must be done "in the same manner as the annual long report". The IA sought further clarification on the meaning of "published in the same manner" where an AFM has multiple funds with different accounting year ends.

The FCA advised the IA that it would consider composite reports issued in line with COLL 4.5.14R, but not necessarily aligned to the annual accounting date of each fund, to be compliant with the requirements of COLL 4.5.7R(9).

The FCA noted the rules around how composite reports should be compiled are deliberately non-prescriptive to allow firms the flexibility to choose a model to compile reports for their funds in a way that best works for them. It considers that what matters more is that whatever model is chosen for the reports, **it is carried out consistently on an annual basis**. It would also expect that the data used to compile the reports is not out of date, or that once the reports are produced, they are published in a timely manner.

The FCA considers that the rules in COLL 4.5.7R(9) provide sufficient flexibility to enable an AFM intending to use a composite report to choose a reference date that enables them to best perform the assessment across their range in a cohesive and operationally efficient manner. AFMs who elect to do

this should publish their statements in a composite report issued in line with the timings specified for the issue of an annual long report in COLL 4.5.14R, i.e. within four months of the reference date used for the value assessment.

The IA further recommends that where AFMs publish their statements on the assessment of value in a composite report rather than in the annual long report, the AFM indicates in the annual long report that it issues the statement on the assessment of value in a separate composite report, and when it expects to publish this.

CONTENT OF VALUE STATEMENT

Whether the statement is included in the annual long report or in a separate composite report, the intention behind the requirement to publish this statement is to bring in an additional layer of transparency as well as scrutiny.

PS18/8 noted that this statement could help "comparison across the sector"[32] and clarified that AFMs can choose to include a combination of qualitative and quantitative information as long as this is not commercially sensitive or anticompetitive. Considering the level of detail and degree of commercial sensitivity of the information that AFM boards will have to take into consideration as part of the assessment, this means that the public statement could be a less detailed summary of a much more extensive report that will only be part of the AFMs internal records. The latter will be essential not only to ensure robust governance but also for AFMs to be able to evidence it particularly in the context of the prescribed responsibility, which in most cases will be attached to the chair of the AFM's governing body[33]. Nonetheless, the statement should include sufficient information to enable investors to understand what factors the AFM board considered and how it reached its conclusions.

COLL 4.5.7R(8) sets out the content of this report:

(8) An annual long report of an authorised fund must also contain a statement setting out a description of the assessment of value required by COLL 6.6.20R including:

a) *a separate discussion and conclusion for the matters covered in each paragraph of COLL 6.6.21R, and for each other matter that formed part of the assessment, covering the considerations taken into account in the assessment, a summary of its findings and the steps undertaken as part of or as a consequence of the assessment;*
b) *an explanation for any case in which benefits from economies of scale that were identified in the assessment have not been passed on to unitholders;*

c) *an explanation for any case in which unitholders hold units in a class that is subject to higher charges than those applying to other classes of the same scheme with substantially similar rights;*

d) *the conclusion of the authorised fund manager's assessment of whether the charges are justified in the context of the overall value delivered to the unitholders in the scheme;*

e) *if the assessment has identified that the charges are not justified in the context of the overall*

[32] PS18/8, page 14.
[33] Where a firm has no Chair they must assign prescribed responsibility 'za' to another appropriate Senior Manager.

> *value delivered to the unitholders, a clear explanation of what action has been or will be taken to address the situation*.

According to this rule, AFMs must provide a summary describing how they considered each of the seven criteria separately (quality of service, performance, AFM costs – general, economies of scale, comparable market rates, comparable services, classes of units), what they found and whether they took any action where issues were identified. Importantly, the rule asks for a separate discussion not only for each of the seven criteria but also "*for each other matter that formed part of the assessment*".

Alongside this separate discussion for each criterion, there is added emphasis on two particular factors. First, there is an additional point requiring AFMs to explain why any identified economies of scale have not been passed on to unitholders. As discussed in the previous section, the text in the policy statement allows for this possibility and outlines examples where this would be the case, e.g. cross-subsidy across the business.

Second, there is an extra emphasis on the 'Classes of Units' criterion which, viewed in parallel with the guidance FG18/3 which was part of PS18/8, might indicate a degree of attention to how firms are addressing legacy share classes may be needed.

The last point in COLL 4.5.7R(8) is very explicit as to what question AFMs should be asking themselves when carrying out the assessment: is the charge justified considering the value delivered? Therefore, even though the criteria cover different aspects beyond cost, the ultimate question is whether the level of charges is justified. This, in turn, would suggest that where any issues have been identified, the expectation is that AFMs consider whether the level of charges should be accordingly adjusted.

Beyond this point, both the rules and the policy statement are silent in regard to the last requirement to provide a "*clear explanation of what action has been or will be taken to address the situation*". As such, having explored the question of whether charges are justified and concluded that this is not the case, AFMs may wish to consider alternative courses of action.

Importantly, as with all investor communication documents, this statement is subject to the 'fair, clear and not misleading' rule. Moreover, although the purpose of this report is to summarise the outcome of the value assessment to unitholders, firms should be mindful of how any historic reports are used in the future for marketing and distribution purposes – if at all.

ADDITIONAL CONTENT

Alongside what the report should cover, as per COLL 4.5.7R(8), AFMs may wish to consider adding further information around the governance arrangements for the value assessment process. This may be critical in the context of the prescribed responsibility 'za', whereby the chair of the AFM's governing body must ensure not only that the value assessment process has been carried out but also that there was independent director representation. A number of AFMs chose to publish a statement from the chair of the AFM Board and/or the independent directors.

In this context, the US experience has highlighted the importance of evidencing robust governance in litigation, where it is less likely for courts to doubt the outcome of the 15(c) process if boards can demonstrate that they were well-informed and carried out a robust process. Although this stems from a different regulatory background which is largely connected to litigation, it is an example of how actions like ensuring all information is readily available, keeping records, seeing that all challenges and questions in the assessment process have been addressed etc. may bear relevance in the context of the prescribed responsibility.

Independent directors have a role to play in effective governance and the FCA have stressed the importance they place on independent scrutiny[34]. COLL 6.6.26G provides further guidance on this role which "*should include providing input and challenge as part of the AFM's assessment of value*" and noted that additional responsibilities could apply such as consideration of remuneration and conflict of interest rules. Firms may take the view that the report can reflect some aspects of this independent challenge.

In this context it should be noted that COLL 6.6.25R(3) requires AFMs to take reasonable steps to ensure independent directors have sufficient expertise to be able to make judgements on whether scheme is being managed in the unitholders' best interests.

IA RECOMMENDATIONS FOLLOWING THE FIRST YEAR OF REPORTING

The IA undertook an analysis of the assessment of value reports issued in 2020. The analysis considered a sample of assessment of value reports issued by Authorised Fund Managers (AFMs) representing around 71% of UK funds by assets under management. The report published in April 2021[35] covered general findings and those related to specific criteria, and made some initial recommendations for AFMs to consider when preparing future assessment of value reports. AFMs may wish to consider the report and its recommendations alongside this guidance.

The recommendations made were as follows:

General areas

Accessibility and location

- Publishing reports in an easily accessible location on firm websites, such as on individual fund pages.
- Making individual fund reports available to investors where there is a wide range of funds.

Structure and Layout

- A statement or summary comment about the year's value assessment can offer a way to connect with investors beyond the formality of the reporting process itself, conveying key wider messages about a firm's ethos alongside more specific material relating to the value assessment.

Overall approach to value assessment reporting

- Wider use of summaries and graphics to illustrate the information provided may be a helpful way of making reports easier to follow. Such an approach may also be helpful in addressing the varying information demands of different investors.

Specific criteria

Quality of Service

- Setting out any measurable factors against which quality of service has been assessed and supporting information, so readers can assess how the Board has reached its conclusions on quality of service.

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[34] For example, in PS18/8, the FCA stated that all investors should benefit from this independent scrutiny "no matter how large the AFM is and how long it has been operating" and this is why they did not reduce the minimum number of independent directors (see page 17).

[35] Value Assessment Reports – Analysis and Initial Recommendations April 2021 https://www.theia.org/sites/default/files/2021-04/IA%20Analysis%20Report%20on%20Value%20Assessments_April%202021.pdf

Performance

- Setting out the investment objective that the fund is aiming to achieve ahead of describing how the fund has performed.
- Providing information on how the fund has performed, or directing investors to where this can easily be found, and consider providing benchmark or comparator information alongside this – firms may wish to consider presenting this using a chart or other visual tools.

AFM Costs

- Setting out a discussion in the report on AFM costs that is distinct from other criteria relating to charges.

Economies of Scale

- Providing a high-level description of how economies of scale are being assessed in the assessment of value report.

Comparable Market Rates

- Setting out the rationale or methodology for how the peer group was selected.
- Setting out the ongoing charges of the fund.

Comparable Services

- Outlining the assessment process undertaken for comparable services, including the types of services assessed, and the outcome of the assessment.

Classes of units

- Including guidance to assist investors in identifying which share class they invest in.

FAQs

Q9.1 Are AFMs required to publish a report?

AFMs must publish a statement outlining the value assessment process and outcomes. This is supposed to be a summary of the assessment process and the conclusions made by the AFM Board, and there is no obligation to disclose information which is commercially sensitive. Firms may wish to add quantitative along with qualitative information subject to none of this being commercially sensitive.

Firms should note that as explained in the IA paper "*Scope of FCA fund governance requirements*", the requirement for AFMs to publish a statement on the value assessment in the annual report for UK authorised funds does not extend to any EEA UCITS managed by a UK UCITS ManCo. It is, therefore, at the discretion of the UK UCITS ManCo how it reports on the value assessment performed for EEA UCITS.

Q9.2 When must firms publish this report?

Where the statement is published in the annual long report, the rules require that the annual long report is published within four months of the end of the fund's annual accounting period. Where the AFM publishes a composite report for two or more funds with different accounting year ends, the AFM can use the same reference date to perform the value assessment for all funds covered by the composite report, but should publish the statements in the composite report within four months of this reference date. AFMs using composite reports should be consistent in the timing of the annual assessments of the funds, ie. the reference date selected for the annual assessment should not be changed from previous

years unless there is an objective reason to do so.

Q9.3 How often should this report be published?

As per COLL 6.6.20R(2), the assessment must be conducted at least annually and COLL 4.5.7R(8) and (9) require for the statement to be published annually either as part of the annual long report of a fund or in a separate composite report covering two or more funds.

In PS18/8, the FCA noted that reporting on an infrequent basis and specifically in line with the recommended holding period would significantly reduce the impact of this policy as people invest in funds on a rolling window basis and often for shorter periods than the recommended holding period[36].

Q9.4 Where should AFMs publish the report?

COLL 4.5.7R(8)-(9) require that firms publish this in either the annual long report or in a separate composite report covering two or more funds.

Firms may wish to consider how a composite report could be prepared in light of potentially different accounting year-ends across their fund range. Moreover, given that this is for the benefit of unitholders, firms may think how to make it easily accessible e.g. put it on the AFM's website, with cross-references and links to any relevant data points in the annual long report if needed.

Q9.5 Should the report and the underlying assessment relate to the accounting year, i.e. be carried out for the period that is covered in the annual long report?

The rules do not actually specify this. COLL 6.6.20R(1) requires that the assessment is conducted at least annually, and COLL4.5.7R(8) refers to the annual long report and COLL 4.5.7R(9) to a composite statement.

AFMs may wish to consider the criteria in the context of the period covered by the accounting year, particularly if they plan to cross-reference data points from the annual long report. Assessment of value may well extend beyond an accounting year, especially for aspects such as performance, but some criteria such as level of charges can be viewed for the given accounting year.

Independently of what period each of the assessment criteria cover, the report will have to be published annually.

Q9.6 Should the report be similar to that of comparable funds?

The format of the report is entirely dependent on what each AFM thinks appropriate. Firms may wish to consider having a similar format across their fund range for operational simplicity.

In regard to similar funds across different AFMs, the FCA noted the potential for the statement "*aiding comparison across the sector*" but it is for each firm to assess how best to discharge their obligations in relation to the value assessment, including how best to convey clear information to the fund's unitholders about the fund itself which may not be comparable to that of other funds. Comparability across the sector is likely to increase over time once the market has seen several waves of these reports and best practice emerges.

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[36] PS18/8, page 14.

Q9.7 When should a composite report include a statement on the value assessment for a newly launched fund?

As new funds are launched, which are being incorporated in the existing composite value assessment cycles, sometimes the next value assessment reference date falls within a relatively short period after the fund launch. This could be in as little as 2-3 months. An assessment of value for a new fund over such a short time period is unlikely to be meaningful. In these circumstances, the FCA has advised the IA that it considers it reasonable for the equivalent provision for the first accounting periods for new funds (where COLL 6.8.2R(4) permits the first accounting period to be extended to the next annual accounting date when the first accounting date falls less than 6 months after the start of the first accounting period) to apply to the first value assessment reference date for new funds i.e where the composite value assessment reference date for a new fund falls less than 6 months after the launch of the fund, the first value assessment reference period can be extended to the next composite value assessment reference date. This first assessment should cover the entire period from launch to the extended reference date.

Q9.8 What process should apply when changing the value assessment reference/reporting dates for composite reports?

While noting that the FCA expects that the processes and timing of composite reports should be consistent, circumstances may occasionally arise where it may be necessary for firms to change or introduce reference dates for their composite reports, eg if an AFM acquires funds from other AFMs, and seeks to align the value assessments for those funds with those of other funds in their ranges, or if they want to move the value assessment for funds previously undertaken line with the accounting dates to a composite report.

In these scenarios, the IA is of the view that changing the reference date for a composite value assessment should be treated the same way as a change to the annual accounting date of the fund. This would include allowing the value assessment period to be extended or shortened by up to 6 months in the event of a change to the reference date, in line with the equivalent treatment of a change in the annual accounting date outlined in COLL 6.8.2R(6). The FCA has advised the IA that this view seems sensible, under the caveat that this only occurs exceptionally.

ANNEX 1

SMCR ASPECTS OF VALUE ASSESSMENT

The Table at SYSC 24.2.6R identifies that the senior management responsibility (za) is:
(20) The responsibilities allocated under COLL 6.6.27R or COLL 8.5.22R (Allocation of responsibility for compliance to an approved person).

SYSC 24.3.3G (2) states:

The relevant rules in COLL deal with the persons to whom a firm should allocate FCA-prescribed senior management responsibility (za) (COLL value for money assessment and independent director requirements).

COLL 6.6.27R states:

Allocation of responsibility for compliance to an approved person

> .27R (1) An AFM must allocate responsibility for ensuring its compliance with COLL 6.6.20R, COLL 6.6.25R, and, as applicable, COLL 6.6A.2R or COBS 2.1.4R to an approved person.
>
> .27R (2) Where the chair of the AFM's governing body is an approved person, the AFM must allocate the responsibility set out in (1) to that person.

The Rules referred to in COLL 6.6.27R(1) not in the value assessment and concerning iNEDs.

DUTIES OF AFMS OF UCITS SCHEMES AND EEA UCITS SCHEMES TO ACT IN THE BEST INTERESTS OF THE SCHEME AND ITS UNITHOLDER

COLL 6.6A.2 R

An authorised fund manager of a UCITS scheme or a UK UCITS management company of an EEA UCITS scheme must:

1) ensure that the unitholders of any such scheme it manages are treated fairly;

2) refrain from placing the interests of any group of unitholders above the interests of any other group of unitholders;

3) apply appropriate policies and procedures for preventing malpractices that might reasonably be expected to affect the stability and integrity of the market;

4) (a) ensure that fair, correct and transparent pricing models and valuation systems are used for each scheme it manages, in order to comply with the duty to act in the best interests of the unitholders; and
(b) be able to demonstrate that the investment portfolio of each such scheme it manages is accurately valued;

5) act in such a way as to prevent undue costs being charged to any such scheme it manages and its unitholders; and
6) in carrying out its functions act:
   (a) honestly, fairly, professionally and independently; and

   (b) solely in the interests of the UCITS scheme and its unitholders.

   [Note: article 22 of the UCITS Implementing Directive and article 25(2) first paragraph of the UCITS Directive]

AIFMS' BEST INTERESTS RULES

COBS 2.1.4 R

A full-scope UK AIFM and an incoming EEA AIFM branch must, for all AIFs it manages:

1) act honestly, fairly and with due skill care and diligence in conducting their activities;

2) act in the best interests of the AIF it manages or the investors of the AIF it manages and the integrity of the market;

3) treat all investors fairly; and

4) not allow any investor in an AIF to obtain preferential treatment, unless such preferential treatment is disclosed in the relevant AIF's instrument constituting the fund.

[Note: article 12(1)(a), (b) and (f) and article 12(1) last paragraph of AIFMD.]

ANNEX 2

VERSION CONTROL – PREVIOUS VERSION CHANGES

July 2019

The key changes that were made to the second edition, published in July 2019, are as follows:

- Addition of reference numbers to FAQs
- 1 Quality of Service: new FAQs on the investment process, corporate governance and stewardship, and services benefiting investors indirectly.
- 2 Performance: changes to explanatory memorandum and FAQ 2.4 to reflect the final objectives and benchmark rules and guidance in FCA Policy Statement PS19/4, new FAQs on assessing active funds in comparison to passives with a similar investment universe, and treatment of income and accumulation share classes for assessment purposes.
- 3 AFM Costs – General: amended FAQ on transaction costs, new FAQ on unaudited costs.
- 4 Economies of Scale: addition in Background of reference from policy statement on explaining why decisions on economies of scale are in the best interests of investors.
- 7 Classes of units: New FAQs on substantially similar rights and on consideration of pricing differences for share classes with different rights.
- Value Assessment – timing and reporting: changes to reflect the clarification received by the IA from the FCA on the timing of composite reports, including amendments to the FAQs on reporting.

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