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UK Financial Conduct Authority sets out its expectations of asset managers and alternative investment firms

Compliance teams within [asset managers](#) and [alternative investment firms](#) can expect a busy 2020. In two separate Dear CEO letters both published by the UK Financial Conduct Authority (“FCA”) on 20 January 2020, the FCA has stated that overall standards of governance in a range of areas fall below its expectations. The letters set out in brief terms the specific ways in which the FCA considers that firms may cause harm to customers or the markets in which they operate. It has invited firms to evaluate whether any of these risks are present in their operations and their strategies for tackling them. It has also set out in brief how it proposes to counter them through supervision.

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The tables below summarise the key risks the FCA has identified, what it considers firms should be doing about them and which supervisory steps it proposes to take.

The FCA’s view of the asset management sector

Risk(s)	Suggested action by firms	Proposed supervisory strategy
Liquidity management – mismatches between terms at which investors can redeem and timescales needed to liquidate assets	Review whether necessary and appropriate action has been taken to address issues identified in letter sent by the FCA to boards of Authorised Fund Managers (“AFMs”) (4 November 2019) and in the initial findings of the FCA and the Bank of England Financial Policy Committee joint review of liquidity risks in open-ended investment funds (16 December 2019).	Continued oversight and interaction with depositaries to ensure AFMs take prompt action to mitigate or resolve potential liquidity issues.
Firms’ governance – inadequate discussion and challenge about important decisions, undue reliance on group structures and risk of conflicts of interest between affiliates	Ensure that steps have been taken to improve governance arrangements in line with the requirements of the Senior Managers and Certification Regime (“SMCR”), which has been in force for all FCA solo-regulated firms since 9 December 2019. See our Ropes & Gray alert for more details.	Work scheduled for the first half of 2020 to evaluate effectiveness of governance, with a particular focus on firms’ efforts to implement SMCR.
Asset Management Market Study (“AMMS”) remedies – weaknesses in competition and lack of transparency on fund objectives and performance	Ensure compliance with rules now in force arising from final report of AMMS, published in June 2017. In particular, ensure that value assessments undertaken, required disclosures made in relation to objectives and AFM governing bodies are appropriately constituted (in line with requirements for	Work scheduled for the first half of 2020 to understand how effectively firms have undertaken value assessments, with a particular focus on whether there has been meaningful challenge from AFM boards on issues including costs, fees and product design.

	at least one quarter of members to be independent and no fewer than two independent directors).	<p>Publication of key metrics such as information on long-term underperforming funds in FCA Business Plan.</p> <p>Further “robust action” where funds identified as delivering poor value. A financial penalty of £1.9 million has already been imposed in one case involving “closet trackers”. At least one similar enforcement investigation is understood to already be underway.</p>
<u>Product governance</u> – failures to ensure risks associated with particular product features are properly managed, potential conflicts of interest and non-compliance with MiFID II.	No specific steps at this stage.	Ongoing work reviewing (1) effectiveness of implementation of product governance provisions and (2) how effectively AFMs from outside the group structure of the delegate investment managers (“host ACDs”) are carrying out their responsibilities scheduled for completion in early 2020.
<u>LIBOR transition</u> – risks will vary from firm to firm.	<p>Review Dear CEO letter on LIBOR sent to dual regulated firms in September 2018.</p> <p>Plan on the basis that LIBOR will cease from start of 2022.</p>	Further communications on specific expectations will follow “in due course”.
<u>Operational resilience</u> – business continuity and protection of client assets	<p>Ensure appropriate management of technology and cyber risk, including through appropriate oversight of third party firms and intra-group service providers.</p> <p>Consider FCA’s December 2018 review of technology resilience in the asset management sector.</p> <p>Promptly notify the FCA of material technological failures or cyber attacks in line with obligations under Principle 11 of the Principles for Businesses.</p>	<p>Proactive technology reviews by the FCA for firms identified as at greater risk of causing harm.</p> <p>Further details of FCA’s approach to strengthening operational resilience for financial services firms (following consultation paper released in December 2019) will be published “in due course”.</p>
Brexit – end of passporting arrangements	Continue to keep under review how the end of the implantation period on 31 December 2020 may affect the firm and its customers.	No specific steps at this stage.

The FCA's view of the alternative investment sector

Risk(s)	Suggested action by firms	Proposed supervisory strategy
<u>Investor exposure to inappropriate products or levels of investment risk</u> – failures effectively to identify client type and investment need, comply with marketing restrictions or rules on approval of financial promotions or adequately assess appropriateness or suitability of alternative investments for retail investors.	Ensure systems in place robustly to assess clients' knowledge and experience where investors are able to "opt up" to elective professional status, ensure that quantitative tests are met and refrain from re-categorising retail clients who do not meet thresholds.	Review of retail investor exposure to alternative investment products, focusing on investors' understanding of risks and control frameworks relating to client asset rules.
<u>Client money and custody asset controls</u>	No specific steps at this stage.	
<u>Market abuse</u>	Implement sufficiently comprehensive and tailored market abuse controls. The FCA has noted that it considers there is "significant scope for improvement" across the sector, although it is not specific about deficiencies it has identified.	Further exercises (similar to those recently concluded) involving visits to multiple firms in the sector to assess the adequacy of market abuse controls. Consideration of enforcement action for breaches of the EU Market Abuse Regulation.
<u>Market integrity and disruption</u>	Operate robust risk management controls to avoid excessive risk taking and ensure potential harm or disruption to financial markets is mitigated.	Possible in-depth assessments of firms' controls, with particular focus on those relating to high-risk investment strategies.
<u>Anti-money laundering and anti-bribery and corruption</u>	Be alert to risk that firms could be used to facilitate financial crime and operate appropriate and proportionate systems and controls.	Reviews of firms' financial crime systems and controls, with particular focus on how firms address anti-money laundering and anti-terrorist financing risks.
Brexit – end of passporting arrangements	Continue to keep under review how the end of the implantation period on 31 December 2020 may affect the firm and its customers.	No specific steps at this stage.

What next?

Whilst the letters are specific to their relevant sectors within the industry, firms should review both letters as there is overlap between the sectors in relation to the issues raised. The letters clearly indicate the FCA's approach and focus on these matters and firms should use this as an opportunity to review their own processes and procedures in light of the letters and make adjustments where necessary.