Compliance Issues in Wealth and Asset Management

SHCOG Securities Houses Compliance Officers Group

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What is Asset Management?

- “Private Banking provides comprehensive advice and a broad range of wealth management solutions, including pension planning, life insurance products and wealth and inheritance advice, which are tailored to the needs of high-net-worth and ultra-high-net-worth individuals worldwide.”

What is Asset Management?

Institutional Asset Management

- “We provide specialist investment management solutions to leading financial institutions around the world. Our clients include some of the world's largest pension funds, mutual funds, sovereign wealth funds and financial institutions.”

What is Asset Management?

“A **hedge fund** is hedge funds are pooled investment vehicles that can invest in a wide variety of products, including derivatives, foreign exchange, and publicly traded securities.”

- CFA Institute

“An offshore investment fund, typically formed as a private limited partnership, that engages in speculation using credit or borrowed capital.”

- Oxford Dictionary

The Context

	Conservative	Income	Growth	Balanced
UK shares	12.5	20	25	22.5
Int’l shares	20	30	52.5	40
Bonds	42.5	25	7.5	20
Cash	5	5	2.5	5
Com. Property	2.5	2.5	2.5	2.5
Alternatives	17.5	17.5	10	10
Total	100	100	100	100

Source: WMA private investor indices

Alternatives: Custom Index of 100% Long MSCI World Diversified Multiple Factor Index + 70% Short MSCI World Index

Recent Regulatory Developments

- Published 3rd February 2023
- “Our Asset Management Supervision Strategy”
- Discusses those areas in which the FCA believes that asset management can cause harm to customers or markets

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3 February 2023

Dear Chief Executive,

Our Asset Management Supervision Strategy

This is our first letter to you since we launched our new integrated regulatory structure across the whole of Supervision, Policy and Competition in the FCA. Asset Management is now supervised by the Buy-Side Directorate of the FCA, and updated contact details are provided at the end of this letter.

This letter outlines the harms to consumers or markets that we think are most likely to arise from 'Asset Managers'[1] business models. It sets out how we intend to supervise the Asset Management portfolio to address these harms and it supersedes our previous strategy letter of January 2020.

The Asset Management portfolio consists of around 1,000 firms managing approximately £11 trillion of assets for UK and global clients, ranging from large institutions to small retail investors. Firms in the sector operate globally. Many UK Asset Managers are part of wider asset management groups serving clients worldwide. The industry provides services that benefit consumers, markets, and global economies. Our supervisory and policy approach is shaped by this context, and by the FCA's overall priorities.

Our review of risks considered a range of information taken from our supervisory work, firm and fund authorisations, external data, and our interaction with asset management associations, and other global regulators.

You should consider whether the risks of harm below are present in your firm and adopt strategies for mitigating them. In any future supervisory engagement with you, we will consider whether your governing bodies, and Senior Managers with accountabilities have taken appropriate action to ensure that consumers and markets are adequately protected from these harms.

Recent Regulatory Developments

- “Our Asset Management Supervision Strategy”
- Product Governance
- Key risk: the quality and value of product offerings, or the quality of communications with customers, do not deliver good outcomes for consumers or meet their needs
- Why? Excessive costs and charges, poor product governance or distribution to the wrong type of investor

FCA will:

- Follow up on its 2021 Assessment of Value review
- Conduct a review in 2024, to assess the embeddedness of the Duty, with a focus on Price and Value.

Recent Regulatory Developments

- “Our Asset Management Supervision Strategy”
- Environmental, Social and Governance (ESG) and Sustainable Investing
- FCA sees an increase in the prominence of ESG and sustainable investment products
- Claims about ESG and sustainable investing can be misleading or inaccurate
- Inaccurate or misleading information damages market integrity an consumer confidence
- It also undermines efficient allocation of capital intended for delivery to ESG outcomes

FCA expects:

- Greater focus on the design, delivery and disclosure of ESG and sustainable investment funds
- Watch out for a review of firms’ ESG oversight practices

Recent Regulatory Developments

- “Our Asset Management Supervision Strategy”
- Product Liquidity Management

FCA’s view of the risk:

- Open ended funds can have a liquidity mismatch between the terms at which investors can redeem and the time needed to liquidate fund assets to meet the redemption request
- Market and pricing shocks have caused liquidity issues for certain funds. Liquidity risks are relevant across a broader set of products

FCA expects:

- Firms to ensure that both exiting and remaining investors are treated fairly
- Asset Managers should work with stakeholders to ensure that operational systems and processes are fit for purpos can
be executed at pace, and can be scaled to handle additional demand when needed

Recent Regulatory Developments

- “Our Asset Management Supervision Strategy”
- Investment in Operations and Resilience

FCA’s view of the risk:

- Underinvestment in operations can lead to service disruption or failure, with consequential loss to investors and detriment to markets
- This may be heightened by increased market volatility or stress
- Poor investment in operations can hamper innovation, reduce efficiency and increase cost, and can result in service decline for investors. It may also result in business disruptions, or lead to vulnerabilities that can be exploited to control systems or inappropriately transfer information

FCA expects:

- Appropriate measures to understand the operational health of the business
- Where outsourcing, there must be sufficient information, skill and knowledge to make sure that third parties will continuall deliver a service which meets regulatory obligations.

The Duty of Suitability

- Suitability arises where you give "Investment Advice" or manage investments on a discretionary basis for retail or professional clients
- *A "personal recommendation" to buy or sell*
- *Relating to a particular financial instrument*
- Given to an "investor" or "potential investor"
- *Based on a consideration of client's circumstances*
- There is a duty to consider and record suitability

Asset Management Challenges

- Product choice – does suitability apply here?
- Advisory and discretionary dealing: need for clarity of:
  - Investment objectives
  - Risk appetite
  - Time horizon

Asset Management Challenges

- Product suitability
- Transaction suitability
- Portfolio suitability

- Is it always straightforward?

Suitability

- Always applies where giving “Investment Advice”
- Your firm cannot contract out of this duty
- No firm big/ugly enough to be disapplied

Consequences of Non-Compliance

- Suitability is a rule in the FCA rulebook
- Likely sanctions:
  - Censure
  - Private
  - Public
  - Fine
- *Civil action*

If in doubt:

- Complete a written record

NB: the “smart lawyer test”

Time Horizon

- Why do so many wealth and asset managers forget this??
- Is it only important for private clients?
- If so, why?

Suitability Best Practices

- Account opening form
- Should have investment objectives
- Risk appetite
- Time horizon

- Systems should make it easy for you

Asset Management Challenges

Best Execution

- What are the challenges here?
- Must you centralise all fund management dealing?
- How do you ensure best execution in less liquid instruments?
- How do you monitor?

Best Execution: Once it Applies…

- Firms must take **all reasonable steps** to obtain the **best possible result** for their clients when executing orders.
- Firms must establish, implement and regularly review a **Best Execution Policy**
- Firms must take into account price, costs, likelihood of execution and settlement, size, nature or any other consideration that is relevant to the execution of the order when determining what is the best possible result.

Best Execution: Once it Applies…

- Firms must provide clients with **information on and obtain client consent** to their Policy. Firms wishing to execute trades outside a regulated market or an MTF must first obtain client consent.

- Firms must be able to **demonstrate at the request of a client** that they have executed their orders in accordance with the firm's Policy

Other Issues

- Allocations: Aviva Investors Global Services Ltd (Aviva) fined £17.6m by FCA in 2015
- Conflicts of Interest: Martin Currie Investment Management Ltd (MCIM) fined £3.5m by FSA in 2012

Potential Conflict	Firm v Client	Employee v Client	Client v Client	Group v Client
Delegate in-house asset manager consistently underperforms versus industry peers	Y	Y		Y
Employee deals personally ahead of a fund deal.		Y		
Client Relationship Manager informs his client that manager of X Fund ($15bn) is leaving the firm. Client holds 20% of the NAV.	Y	Y	Y	
A fund invests in the listed holding company's shares. PM's vote in favour of the HoldCo's remuneration motion.		Y		Y
PM receives a compelling investment idea from a research provider and places the trade with the research provider's traders. Monitoring shows that the PM attended 2 events with the trading firm.	Y	Y		Y

Thank you for attending

Any Questions?
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