Financial Services Regulatory Insights

FCA sets out Asset Management supervisory priorities and Consumer Duty expectations

AT A GLANCE

February 2023

What's new?

- The FCA wrote to CEOs of Asset Managers (AMs) on 3 February 2023, setting out its view on the harms and risks in the sector, its activities around these, and its expectations of firms. This is the first AM strategy supervision letter in three years. It simultaneously wrote to firms to underline its expectations on the new Consumer Duty rules.
- The FCA highlights five key areas: product governance including consumer duty, ESG and sustainable investing, product liquidity management, investments in operations and resilience, and financial resilience.
- But it also underpins these areas with a strong message on the need for good governance, with sufficient expertise and understanding of these risks. During this cycle it will assess the effectiveness of governance in identifying, considering and mitigating harms, against both firms with known issues and against outliers in the five highlighted risk areas.

Contacts

David Croker
Partner
T:+44(0) 7718 097331
E: david.w.croker@pwc.com

Andrew Strange
Director, FSRI
T: +44(0) 7730 146626
E: andrew.p.strange@pwc.com

What does this mean?

- FCA's supervisory strategy letters provide unique insight into the supervisory activity and expectations of the FCA. The focus of this cycle is:

Product Governance

- The FCA remains concerned that products may not offer the quality or value, communications or outcomes needed by consumers. The AM Market Study, and the incoming Consumer Duty rules (applicable to any AM firm which determines or has a material influence over retail customer outcomes) will continue to tackle this.
- The FCA will follow up on its 'Assessment of Value' review, identifying outlier firms (e.g. where not all the minimum considerations are applied, value assessed at fund rather than unit class etc.) and will conduct a review of Consumer Duty in 2024 with a focus on price and value.

Consumer Duty

- The FCA also separately set out key challenges for AMs in a letter. Firms will have seen the broader feedback on implementation plans for all FS firms, in particular noting prioritisation. But for AMs the FCA specifically highlights that:
  - the rules do not just apply to those firms with direct customer relationships
  - the need for data exchange across the value chain
  - the interaction with COLL and PROD rules.
- Consumer Duty underpins much of the FCA's wider approach and should be considered in conjunction with the strategy letter.

ESG and sustainable investing

- With the rise of ESG, the FCA remains concerned about the accuracy of some ESG claims.
- FCA previously wrote to AFM Chairs about this, and in-scope firms are already preparing to make their first TCFD-aligned disclosures during H1'23. The FCA will also finalise its SDR and labeling rules this year.
- The FCA will underline this by focusing on the governance of firms, again particularly on outliers. It expects governing bodies to be appropriately structured to oversee and challenge product development,

ESG and sustainability in investment processes, and third-party and proprietary information providers.

Product Liquidity Management

- Concerns relating to open-ended funds continue, particularly in light of recent voliatively and LDI risks. The FCA wants to see the correct use of tools to ensure consistency and fair treatment of exiting and remaining investors.
- The FCA is currently completing a liquidity management multi-firm review. It will use this to identify outliers, and will expect firms to consider their own governance, oversight, in response to the review.

Operations and resilience

- The FCA is concerned by underinvestment in operations and the potential impact that can have on resilience, particularly if firms rely on (intra-group or external) third parties. A firm needs sufficient information, skills and knowledge to ensure it can meet its regulatory obligations.
- FCA notes that relevant firms must be operating within their important business services impact tolerances by 2025.
- FCA sees variable levels of incident reporting across all AM firms. It is going to proactively monitor firms, including reviews using its cyber and operational resilience assessment tools and intelligence-led penetration testing scheme (CBEST).

Financial Resilience

- Firms have implemented the IFPR over the previous supervisory cycle. Given the economic environment, FCA expects firms to have sufficient capital and liquidity, but also to review wind-down procedures. It also notes the importance of safe custody of clients' assets and money.
- It will continue to undertake targeted visits, and where failure occurs seek to minimise harm. During H1'23 it also expects to publish initial observations on firms' implementation of the IFPR, which firms will need to review and ensure are reflected in their processes.

What do firms need to do?

- Governance is critical to each of these areas, so firms should review each issue and ensure detailed discussion and ownership by the Board, reinforcing accountabilities across all Senior Managers.
- This includes proactively reviewing and updating wind-down plans to ensure they are fit for purpose, and reviewing IFPR implementation activity, ahead of the results of the FCA review.
- Firms must ensure they have appropriate measures to understand the operational health of the firm, and assess the use of any third parties. This should include contracts, contingency plans and data/metrics to manage risk.
- The Consumer Duty rules underpin much of this agenda. Firms must urgently review their existing plans against this and broader feedback, making changes as necessary to ensure alignment with FCA expectations. Firms should reconsider work on AoV against FCA's previous feedback and in light of the new Consumer Duty rules.
- Firms should undertake a thorough review of their approach to liquidity risk management, focusing on whether they can execute at pace, and scale to handle additional demand when needed.
- The FCA repeatedly references 'outliers' in its supervisory approach, which is driven by data. Firms must analyse the robustness of their data and FCA reporting, ensuring challenge and ownership by Boards.

Next steps

Firms must systematically analyse, review and address each area of potential harm highlighted by the FCA, taking and evidencing demonstrable actions. The focus on governance should underpin this, with Boards fully owning this agenda, and their firm's response.

Contacts

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Partner

T:+44(0) 7718 097331
E: david.w.croker@pwc.com

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