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The FCA Is Set to Continue Its Focus on the Asset Management Industry. Are You Prepared?

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The U.K. Financial Conduct Authority (the “FCA”) has issued several “Dear CEO” letters since the beginning of 2020 indicating that the standards of governance within the asset management industry need to be improved further to meet the regulator’s expectations.

The FCA conducted a number of thematic reviews and market studies in the sector in the course of 2019, including its analysis of the asset management market which resulted in the set of remedies published in the Policy Statement PS 19/4 in February 2019 and the reports on the investment firms with appointed representatives (20 May 2019) and the risk modelling and other portfolio management tools used by the managers (13 January 2020). However, the recent “Dear CEO” letters are a clear indication that the FCA will continue its focus on improving the compliance standards in the asset management industry.

Thematic work and issues identified in “Dear CEO” letters invariably result in follow-up from the FCA. It is important for firms, therefore, to identify whether these matters highlight any shortcomings or gaps and, if so, implement a plan to remediate.

Areas that require focus include:

1. Appropriateness and Suitability of Investment Products for Investors

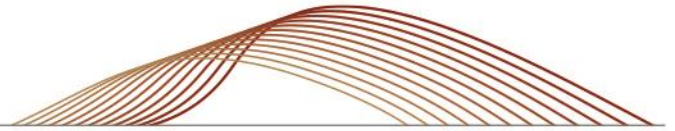
Firms are required to understand their clients, including their knowledge and experience, financial situation, investment objectives, and risk tolerance and carry out suitability assessments to ensure that the proposed portfolio management activities are suitable to each client.

In addition, since fund managers are in many cases co-manufacturers and/or distributors of products, they are required to comply with the MiFID Product Governance Rules and must identify the client type and investment need for the funds they manage, recognising that they may only be appropriate for a very specific market. This is a particular concern where a manager has retail clients.

Moreover, when carrying out marketing of the funds, firms must have appropriate systems and controls in place to comply with restrictions on marketing to retail investors.

2. Market Abuse, Anti-Money Laundering, and Anti-Bribery and Corruption

Firms are required to have appropriate procedures and controls in place to enable them to discharge their obligations under the above regimes. The FCA expects such controls to be tailored



to the firm's individual business models so as to effectively mitigate financial crime risks in the context of their business models. Firms should pay particular attention to how they conduct due diligence on third party providers, customers and investors. Firms should review market abuse policies in connection with transactions in securities that are subject to market abuse regime.

3. Brexit Implications

It is almost certain that Brexit will lead to firms losing their passporting rights under the EU Directives which currently enable them to provide a range of investment services to their European clients and investors. The FCA would expect the firms to have contingency plans in place as required under the regulatory system and be able to explain to the regulator how they intend to deal with an impact of Brexit on their services and existing EU customer base. Many firms review the position in the run up to the original March 2019 Exit Date. Firms should consider whether changes have occurred in their circumstances or assumptions in the period since then. For example, if any mandates have been received from EU-based clients.

4. Adequate Financial Resources and Professional Indemnity Insurance

The FCA has raised concerns that some businesses are not being fully compliant with the applicable capital requirements and do not hold an adequate capital and/or professional indemnity insurance appropriate to their business model.

5. Compliance with Oversight and Control of Client Money and Client Assets

The FCA intends to investigate whether firms that have permission to hold client money and safeguard custody have robust systems and controls in place to minimise the risk of losing clients' money or assets.

In summary, the FCA intends to carry out further audits and reviews in the asset management industry with a likely focus on the above topics. Some firms will shortly receive specific written requests for information from the regulator or may be subject to office inspections. Therefore, U.K.-based asset managers should take pro-active steps to review their current policies and procedures to ensure that their current systems and controls are fully compliant with the relevant legislation and the FCA Rules. With respect to Brexit contingency plans, they should ensure that they have a clearly defined and up-to-date action plan on how they intend to service their EU-based clients following the U.K. leaving the EU.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:

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