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THE FIVE KEY QUESTIONS THAT ALL GOOD INEDS SHOULD ASK!

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porting Season Ahead

17 October 2013

Investment Manage

Knowledge

Ind cutive

ernance in our changing
regulatory landscape

THE EIGHT KEY QUESTIONS
WE WILL ASK YOU!

11 June 2014

Agenda

	Speakers
Introduction	
Opening Address – A UK Perspective	Miles Bennett
Risk Intelligence	Sean Smith
Governance Round Table – 8 Key Questions	

Opening Address

A UK Perspective

Miles Bennett

Background

Context to FCA's focus on Conduct

A	**New Regulator** • Differentiate from FSA • Focus on Conduct • New powers e.g. competition remit
B	**New Supervisory model** • Forward looking approach • Focus on customers interests
C	**Conduct Risk definition** • Different from FSA initiative of Treating Customers Fairly (TCF) • The risk that firm behavior will result in poor outcomes for customers
D	**Conduct Risk in practice** • Fair treatment of customers at the heart of firms' business • Demonstrating good conduct to FCA supervisors can be a challenge • The end to end customer journey (design, distribution, understanding)

FCA's Asset Management strategy

Asset Managers as Trusted Agents

Fair	• Manage conflicts of interest • Spend clients' money (on research) as if their own • Investment decisions comply with investors' aims
Transparent	• Bundled charges can mean extra costs to investors • Provision of more data to empower customer decision making • Lack of transparency may lead to inappropriate behaviours
Competitive	• New FCA objective • Assess competition through market studies • Competition review of Wholesale sector announced in 2014/15 business plan

FCA's Asset Management strategy

Looking at investment funds coherently

Organised

- Fund Authorisations team moved to Supervision
- New Fund Supervision team
- Products assessed via "deep dives" and thematic reviews

Analysed

- Business model analysis by sector team
- More reporting received as a result of AIFMD
- FCA required to report to ESMA

Competitive

- Close liaison with HM Treasury
- Fund authorisation timelines revised
- Introduction of Authorised Contractual Schemes

FCA's expectations on corporate governance

The importance of Independent non-Executive Directors

UK Corporate Governance Code

- Constructive challenge and help in developing proposals on strategy;
- Scrutiny of management's performance in meeting agreed goals and objectives and the monitoring of performance reports;
- Satisfying themselves on the integrity of financial information and that controls and risk management systems are robust and defensible;
- Determining appropriate levels of remuneration for executive directors;
- Appointing and removing executive directors, and succession planning.

UK Approved Persons regime

- 7 Principles for FCA Approved persons
- Integrity for role and act with skill and diligence
- Adhere to proper market conduct
- Open and cooperative dealings with the regulator and that the accountable functions comply with the regulatory system
- Take reasonable steps to ensure the business is properly organised and controlled

UK Director Duties

- Exercise care skill and diligence
- General knowledge skill and experience that the director has – subjective test
- Understand risks around operation of fund scheme
- Understand regulatory obligations
- Understand what acting in the interests of the fund scheme and unitholders may entail

FCA Fund Charges Thematic Review

- Firms to ensure that their charges are clear to investors
- FCA tasked asset managers to review current arrangements to satisfy themselves that their practices in relation to both the clarity of fund charges and fund governance are appropriate
- UK system of ACDs for OEIC funds does not require independent NEDs which increases potential for conflicts of interest

FCA's Thematic Reviews

Involvement of Non-Executive Directors

Conflicts of interest

- FCA identified serious issues from thematic review as published in November 2012.
- CEO attestations required from 125 firms
- Firms must meet requirements of SYSC 4, SYSC 10 and COBs.
- FCA principles and rules must be embedded in the business and Boards to regularly review

Board discussions

- What types of conflicts arise?
- Where and who records them?
- Constructive challenge from NEDs as business evolves

Outsourcing

- FCA published results of its thematic review in November 2013
- Key findings around:
  - Resilience risk - asset managers largely unprepared for failure of a service provider
  - Oversight risk – only some asset managers could show high standards of oversight over service providers

Board discussions

- What key activities are outsourced and to which entity?
- What MI does the Board receive about oversight arrangements?
- What is the nature of discussions about new outsourcing arrangements?

Risk Intelligence
Sean Smith
Director - ERS

Background

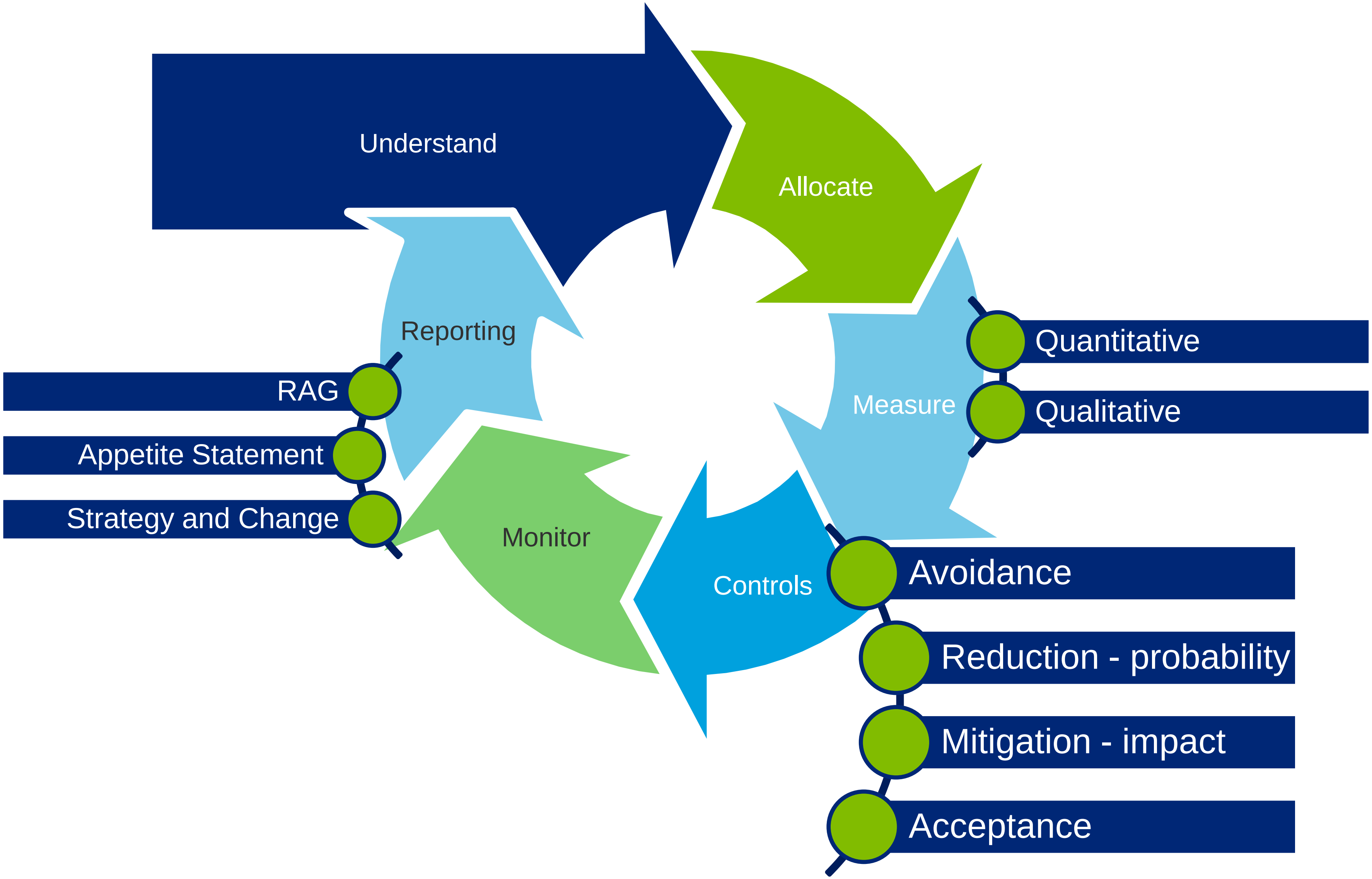

Legal
Recent legal decisions - Weavering and Morgan Keegan
Fund promoters
Increasing expectations on INEDs from fund promoters
Risk Intelligence
Shareholders
Increasing expectations, transparency, protection and fiduciary obligations
Regulatory
Increasing focus on risk management .and outsourcing obligations
Financial crisis
Increasing focus on corporate governance

Challenges

Expectation	Challenge
Role of company director	Role of fund director
Arms length transactions / due diligence prior to appointment	Group Companies / legal launch vs governance launch
Outsourcing	Funds outsourcing model
Risk makers / managers	Risk takers

Core Obligation – Shareholder Protection

Risk Process



Risk Process

- Understand – The initial assessment should seek to understand the risks associated with the fund in question. This exercise should be as holistic as possible focusing on all aspects of risk faced by the fund and not just investment risk. While many of the risks will be generic to all funds it is important to consider them in light of the specific fund and its fund providers. Directors should consider macro and micro risks and how they might impact shareholders and/or fund transparency

- Allocate – This stage is possibly the most difficult as it requires directors to identify the risks that are managed by service providers and the risks that are reserved to the board. The assessment should focus on where those risks should be managed and should also seek to identify risks that are not currently owned by the board or service providers.

- Measure – Risk that remains with the board should be measured using quantitative and qualitative factors. Quantitative factors focus on hard facts, for example number of errors, cost of errors etc to quantify and measure risk. Qualitative factors tend to focus more on judgement, for example the type of people managing a risk function. A key factor in measuring risk is understanding the risk factors, in other words the things that drive or increase risk. Risk that sits with a service provider should not be measured by the board, instead the service provider should give the board comfort that risks are being measured appropriately. The board may seek to challenge the service provider in this regard. The level of oversight conducted by the board should be commensurate with the level of risk present.

- Manage – This process looks at the controls in place at a board level and within the service providers to assess if they are appropriate for managing the level of risk. The higher the risk the more onerous the controls that should be in place. Where risk is managed by a service provider, the board may ask the provider to demonstrate how the controls in place are adequate and effective to reduce risk to an acceptable level.

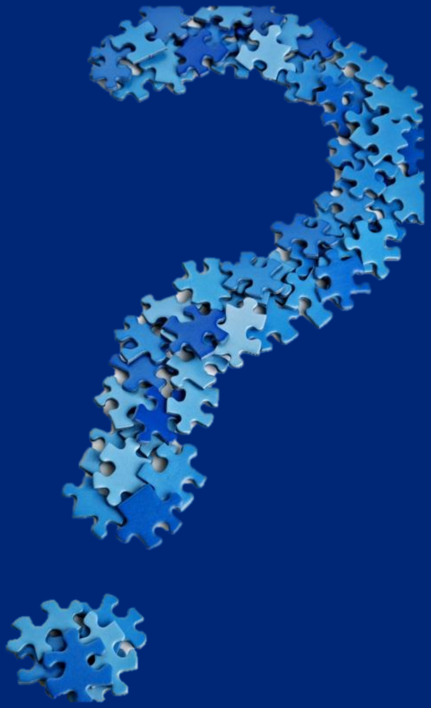
- Monitor – This analysis considers how the identified risks are monitored on an ongoing basis and that the controls are being applied. At a board level, risks may be reviewed at board meetings whereas when a risk is managed by a service provider the board may take comfort from the compliance or internal audit function in respect of their monitoring activities. The board may request sight of such reviews.

- Reporting – This is a key element of risk management for the board. Service providers should deliver accurate, concise and timely reporting of risk in a format that can be understood and acted upon. Trend analysis and forecasting can also be useful tools for predicting future risks and issues. Risk escalation procedures and risk escalation points should be agreed so that urgent matters are brought before the board before the next scheduled board meeting.

What a risk model should not do

- Require risk experts – the board are not expected to be risk experts, the focus is on understanding, oversight and challenge
- One size doe not fit all – every fund will carry with it unique risks that must be reflected in the model adopted
- Overly complicated – the model should be easy to understand and create the most impact for effort
- Create additional unnecessary and costly obligations
- Impractical / unworkable

Questions



Question (Tables 1 – 4)

- Have you experienced an increasing trend towards applying higher expectations to fund boards?

Question (Tables 5 – 8)

- The fund model is traditionally described as an outsourcing model, do you agree that this reflects the relationships between the fund board, promoter and service providers?
- Is there a more accurate way of describing this relationship?

Question (Tables 1 – 4)

- How does a board get comfortable that all fund risks are identified and that all fund risks are owned by one of the service providers?
- How does a board get comfortable with the risk infrastructure in a service provider?

Question (Tables 5 – 8)

- What level of oversight is appropriate for outsourced risks?
- Are there any examples of where this has worked well?

Question (Tables 1 – 4)

- Are there any risks that a fund board cannot outsource / delegate?
- How should these risks be managed by a board?

Question (Tables 5 – 8)

- Should Directors conduct due diligence on a fund prior to appointment, if so, what level of due diligence is appropriate?
- What steps should a fund director take to understand the governance/ risk management DNA of the fund?

Question (Tables 1 – 4)

How do you get comfortable that risks around new products / new legislation etc are being managed appropriately by the service providers?

Question (Tables 5 – 8)

What risks in a fund scenario keep you awake at night?

Question

What types of management information have you found useful in understanding the risks that are managed by the service providers?

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