Assessing the Assessments of Value

Summary article from FBC's iNED Council – 12th November 2020

This year has seen many fund boards produce their first Assessment of Value (AoV) reports – despite the huge challenges 2020 has posed for everyone.

With the Financial Conduct Authority's (FCA) formal reviews of the first AoV reports delayed due to the disruption caused by the pandemic, FBC was pleased to welcome Nick Miller, the regulator's head of asset management, and Garry Murdoch, technical specialist, to the bi-annual FBC iNED Council on 12 November 2020. The meeting provided an opportunity for members to hear an overview of the interactions the FCA has had with asset managers regarding AoV and their impressions from the first year's offerings from the industry.

While it has only engaged on AoV with a "very limited sample" of companies – reading reports and interviewing directors – there were several findings that will be valuable to all fund boards as they continue to develop their approaches.

A mixed picture

In general, the reports received a positive endorsement from the regulator. Most were easy to find, well structured, and developed with a clear focus on the end customer. The reviewers mostly found it easy to navigate documents to find specific products and to understand how they had been assessed against the FCA's seven criteria[1] – although one or two were not as readily available to investors, for example by being clearly signposted on a firm's website, as the regulator would like.[2]

It was clear that, for most reports, "a lot of time and effort had been put into their creation," Murdoch said. However, some analysed the fund range without detailing the assessment of specific funds, for example, while others were criticised for a lack of detail about how the fund board reached its conclusions.

The FCA's value assessment criteria were worded so as not to push boards towards a box-ticking approach, and to instead "reach a judgement" based on the specific circumstances of their companies and investors.

"We recognise that we 're asking you to do a very difficult job: to correct a market failure," Murdoch acknowledged. "We're asking you to put yourselves in the position of the consumer."

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[1] Performance, AFM costs, economies of scale, comparable market rates, comparable services, share classes, and quality of service.

[2] FBC members can access a library of AoV reports via the members' portal at https://fundboards.org/aov-report-bank-fbc-members/.

A more hard-and-fast set of rules "would have been pretty pointless", he added, as it "wouldn't force the directors to really apply their judgement – and that's what we're looking for".

However, the wording of the criteria was still carefully chosen – and some boards were not interpreting the rules in the way the FCA intended. For example, Murdoch highlighted the treatment of AFM costs.

"That is about the costs incurred in providing services… it's a way of talking about the profitability of the service," he explained. "We saw quite a few firms that were leaping straight to the charges and effectively performing a benchmarking exercise of their charges versus competitors, which is not what that factor is about."

Had the FCA performed a full review, he added, it would have emphasised the need to ensure boards have a full understanding of the AoV requirements.

One delegate said this demonstrated that fund boards likely did not fully understand the regulator's intention, as "no one guessed" that the AFM costs criterion was supposed to be focused on profitability of services.

The FCA was also critical of firms that relied too much on consultant advice. "You're welcome to use whatever forms of advice you think are needed," Murdoch said, "but, ultimately, as a board you need to stand behind the approaches that you take."

Good and bad practice

The regulator acknowledged that some shortcomings were inevitable given these were the first iterations of AoV reports. Throughout this year at FBC meetings, attendees have debated lessons from the first reporting process that can be taken forward to inform future reports.

Murdoch said the FCA had yet to see an asset manager that had properly addressed the economies of scale factor "in a way that we would expect".

"Economies of scale is a core concept within the economics profession – it means something in particular," Murdoch said. "When we asked firms what their concept of scale was, for example, to use as a base point to determine whether [investors] were enjoying economies of scale, they hadn't even started to think about that."

As one delegate pointed out, there had not been any meaningful research into this theme for the UK asset management industry, so it would likely require some significant work to understand how to take this forward.

Murdoch also referenced the FCA's Policy Statement 19/4. Published in February 2019, this set out the FCA's rules and guidance on setting fund objectives and benchmarks[3]. While these were not central to the AoV process, he argued that they were worth considering as they played a role in informing how boards assessed each fund – particularly the performance factor.

Some companies had rewritten their fund objectives or changed benchmarks to ensure they were appropriate and understandable, which Murdoch indicated would likely be deemed good practice in the FCA's final report.

[3] PS19/4: Asset Management Market Study – further remedies, February 2019.
https://www.fca.org.uk/publication/policy/ps19-04.pdf

The regulator also raised concerns that some managers had explained poor performance by referencing value investing being out of favour – despite no references to a value style in the fund's literature. Murdoch hinted that the value assessment process "might change the way in which firms interact with their investors regarding their fund descriptions".

Defining success

These are still early days in the FCA's interactions with fund boards and asset managers on AoV, but already the regulator has made it clear that the remedies proposed after the Asset Management Market Study were beginning to have the desired effect.

"Obviously, it was never going to be all delivered this year, Murdoch said. "I think it's going to take several interactions between us and the industry in order for us to get to a place where we're all comfortable."

Fund boards can expect many more visits (virtually, for now) to ascertain how rigorously they have applied their processes, and how their conclusions can be supported by the evidence they have gathered. Expect much more assessment of your assessments to come.