



The FBC Report: Distribution Oversight

Key questions and best practices

Excerpts of full
report

FBC

FUND
BOARDS
COUNCIL

UK, IRELAND AND LUXEMBOURG

Contents

1

Introduction
A focus on distribution oversight

2

Key findings

3

Appendix

chapter **one**

Introduction
A focus on distribution oversight

Introduction

Distribution oversight is an increasingly important topic on the fund governance agenda in Europe, attracting greater regulatory attention in recent years.

In the UK there have been many different regulatory initiatives that point to, or infer, a requirement for better distribution insight and oversight, both by asset management firms themselves, and of course by the Authorised Fund Manager (AFM) boards that govern UK fund ranges.

Key initiatives include the Financial Conduct Authority's (FCA) Assessment of Value (AoV) and product governance (PROD) requirements which apply to UK AFMs. The FCA's PROD rules contain requirements for distributor due diligence (DDD) and prompted the development of the European MiFID template (EMT).

While distribution oversight has had little direct regulatory focus in the UK to date, it also featured in findings of the FCA's MiFID II product governance review in February 2021 which highlighted areas for improvement for distributors. Some of these will surely be enabled by the wide-ranging initiatives introduced by the forthcoming Consumer Duty reforms.

The situation in Ireland and Luxembourg is a different story. The standard EU fund structure, UCITS (Undertakings for the Collective Investment in Transferable Securities) benefits from clearer regulatory expectations when it comes to distribution oversight.



This report, and the recommendations within, is mainly targeted at the fund/management company boards, the directors who sit on these boards, and the key executives charged with supporting positive outcomes on these boards.

A focus on distribution oversight

Distribution oversight is arguably a subset of a bigger-picture set of controls within AFMs and is closely associated with issues like liquidity risk management.

For example, the war in Ukraine and subsequent sanctions imposed on Russia is an example of a liquidity event where AFMs needed to identify investors of a particular type or nationality in their funds.

The aim of the **FBC Report: Distribution Oversight** is not to focus on the individual client aspects of distribution oversight such as know your client (KYC) and anti-money laundering (AML) provisions. As important as these issues are, for this report we are interested in a more broad-based understanding of any given fund's investor base, which we believe is essential to facilitate an effective governance approach. Readers may remember the similar challenge of heightened regulation caused by the 2014 introduction of the US Foreign Account Tax Compliance Act (FATCA).



Only two years later it was the turn of open-ended UK property funds to suffer some unwelcome time under the spotlight following the EU referendum vote. During this time providers had to rapidly create client dashboards, report flows daily to the FCA and generally apply a higher-than-normal degree of 'distribution oversight' to better estimate client behaviour and holding/selling intentions.

Regulators may reasonably expect that knowing who is in a fund is not that big an ask. After all, the Treating Customers Fairly (TCF) regulations back in 2006 would have created an expectation that fund groups (if not boards) were at least monitoring client flows and patterns of investing behaviour.

The actual current situation in the UK today is rather more mixed. While UK AFMs acknowledge the importance of distribution oversight, research for this report suggests that it is being carried out inconsistently and in response to a multitude of differing regulations.

Cross border distribution is a key attraction of the EU's UCITS fund structures. For this reason, there has always been a greater focus on distribution oversight and a typically more prescriptive approach in the major fund centres of Dublin and Luxembourg.

These expectations are outlined in the Central Bank of Ireland's (CBI's) CP86¹ and the Commission De Surveillance Du Secteur Financier's (CSSF's) 18/698² requirements.

chapter **two**

Key findings

Key findings

FBC's belief that this subject will benefit from further industry discussion is a view echoed by the many fund board professionals FBC engages with on a regular basis as part of our ongoing work and believes the key benefits of effective distribution oversight are:

- **Enhanced confidence** that fund sales are being made to appropriate target markets, ultimately ensuring that customer needs are met.
- **Commercial benefits** from a robust, well-challenged distribution strategy.
- **Risk management** benefits in terms of improved management of liquidity and reputational risk.

Nature of fund distribution

- Wholesale fund distribution is increasingly intermediated. While this has been the case in the UK for many years, the European platform market is now developing quickly.
- Widespread platform adoption creates fund 'look through' challenges for fund groups in terms of reliance on these platforms for meaningful data.
- UK fund groups in particular feel strongly that the FCA needs to mandate the provision of richer data by platforms.
- The strong growth of direct investing via platforms and apps is also an emerging distribution oversight challenge in the UK and Europe, with a lack of data again being a key issue.



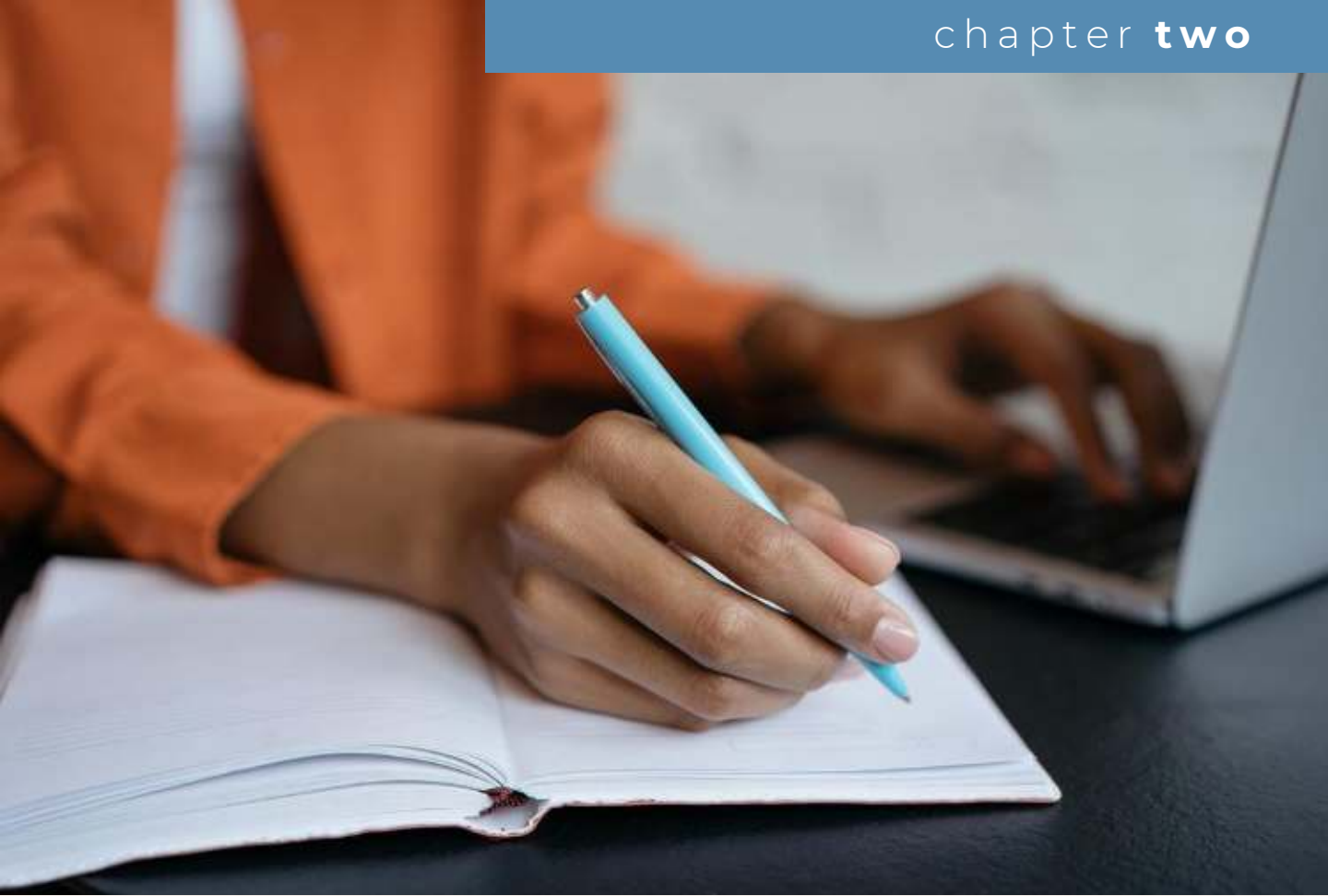
Distributor due diligence (DDD)

- Views differ significantly as to which firms are distributors, especially in the UK (see 'Identifying the distributor')
- Fund groups generally have processes in place to undertake distributor due diligence, but many feel this yields sub-optimal insights.
- The significant growth of UCITS ETFs poses additional challenges, where distributor due diligence today is focussed on the relatively low number of 'Authorised Participants' (the legal shareholders of ETFs). Currently there simply is no data to enable client 'look through' and insight on ETFs.



UK vs. Ireland vs. Luxembourg

- Discussions around distribution gets less focus and challenge at UK fund boards compared with Irish and Luxembourg fund boards.
- Irish and Luxembourg fund domiciles benefit from more clearly prescribed regulatory guidance for DDD, especially in Luxembourg.
- UK fund board directors agree that action is required to address shortcomings in how distributor oversight takes place today.
- Due diligence technology is increasingly being adopted in Ireland and Luxembourg to meet the challenge of conducting initial and ongoing DDD.
- A surprisingly large proportion of fund groups are seeking to embed a holistic approach to distribution oversight that works for all fund structures and all jurisdictions. This means some groups are adopting the most stringent regulatory rules across all jurisdictions as part of a consistent 'good governance' approach.
- The level of distribution knowledge on fund boards was cited as a challenge for Irish and Luxembourg jurisdictions and was sometimes felt lacking in all fund regulators.



Features of good distribution governance

- The regulatory focus on fund liquidity in recent years has reinforced the need for better insight on the underlying 'client liquidity' – i.e., looking through to whether investors are short-, medium- or long-term investors.
 - This will allow for improved monitoring of fund concentration by client and consideration of the risks of significant clients exiting a fund (e.g., in times of increased fund illiquidity)
- Good distribution governance approach requires evidence of analysis and challenge of relevant quantitative management Information (MI) as well as qualitative discussions.
- Key qualitative themes worthy of robust discussion include:
 - Understanding the distribution strategy
 - Challenging the distribution and marketing plans for new product launches
 - Overseeing the 'activities' of distribution, branches, new market entry etc.

appendix

Full report contents
About FBC

Full Report Contents

1

Introduction
A focus on distribution oversight
Research scope and approach

2

Key findings

3

Identifying the
distributor

4

UK focus

5

Luxembourg and
Ireland focus

6

Importance of
quantitative
analysis

7

Governance

8

In the boardroom

9

Conclusion
and action points



About Fund Boards Council

Fund Boards Council (FBC) is an expert led, independent organisation wholly dedicated to supporting fund boards, including the individuals and teams crucial to their success, to achieve good practice fund governance in the UK and cross-border.

With the increasing regulatory scrutiny, individual accountability and the 'primacy' of fund boards expected by the regulatory bodies, the need to continuously be able to demonstrate good governance, and its impact in providing value to customers, is ever pressing.

We are proud to have over 50% of UK fund boards and their investment governance colleagues, by mutual fund assets, as FBC members. Through thought-leadership, practical insights on vital topics, collaboration, training and consultancy, we support and bring together our members, and other senior executives, in delivering robust fund governance.

To make sure your fund board governance is operating at optimum levels, contact us at contact@fundboards.org for advice on membership, training and consultancy.

This report has been prepared for general guidance of matters of interest only and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contains in this publication, and to the extent permitted by law, Fund Boards Council does not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. © 2022 Fund Boards Council.